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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1935

No. 785 4

FRANK M. McKEY, TRUSTEE IN BANKRUPTCY, PETITIONER,

vs.

MAURICE PARADISE, AS TRUSTEE

No. 786 5

FRANK M. McKEY, TRUSTEE IN BANKRUPTCY, PETITIONER,

vs.

MAURICE PARADISE, AS TRUSTEE

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

4

PETITION FOR CERTIORARI FILED MARCH 4, 1936.

CERTIORARI GRANTED APRIL 6, 1936.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1935

No. 785

FRANK M. McKEY, TRUSTEE IN BANKRUPTCY, PETITIONER,

vs.

MAURICE PARADISE, AS TRUSTEE

No. 786

FRANK M. McKEY, TRUSTEE IN BANKRUPTCY, PETITIONER,

vs.

MAURICE PARADISE, AS TRUSTEE

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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[fol. 1] [Caption omitted]

[fol. 2]

IN UNITED STATES DISTRICT COURT, NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION

No. 55173

In the Matter of GRIGSBY-GRUNOW COMPANY, Bankrupt

PETITION FOR ALLOWANCE OF PREFERRED CLAIM—Filed June 29, 1934

At Chicago, in said District of Illinois, on the 26th day of June, A. D. 1934, came Maurice Paradise, as Trustee, of Chicago, County of Cook, State of Illinois, and made oath and said that he is duly authorized to make this Proof on behalf of, and for the benefit of those persons more particularly described hereafter, and says that the person against whom a Petition for Adjudication of Bankruptcy has been filed, was, at, and before the adjudication herein, and still is, justly and truly indebted to Maurice Paradise, as Trustee, for the benefit of those persons more particularly described hereafter, in the sum of Fourteen Thousand Six Hundred Seven Dollars and Fifty One Cents ($14,607.51), [fol. 3] with interest from the 12th day of August A. D. 1933 at the legal per centum per annum; that the consideration of said debt is as follows:

That on to-wit: the 4th day of February A. D. 1933, and prior thereto, the bankrupt maintained, in connection with its business, and for the benefit of its employees, an organization known as "Majestic Employees Welfare Association"; that the purpose and object of said association was to provide certain insurance and health benefits for the employees of said bankrupt; that as incidental to their employment and to obtain the benefit and advantage of the protection and insurance of said Majestic Employees Welfare Association, there was deducted from the salary or wages of each employee of the bankrupt, the sum of Twenty Five Cents (25c) per week; that upon the deduction of the said sum, the bankrupt had obligated itself by the terms and provisions

of the charter, constitution, and by-laws of said Majestic Employees Welfare Association to turn over immediately the aggregate of said deductions from the salary or wages of said employees, to the Majestic Employees Welfare Association; that said association was thereupon to invest and reinvest the moneys thus acquired and accumulated in certain sound securities more particularly specified in said constitution or by-laws of said association, to the end that the interest or other increment earned by said investments would be available for the insurance and health benefits contemplated in the organization of said association; that on or about to-wit: February 4, 1933, the bankrupt deducted certain large sums of money from the wages or salaries of its employees; that said bankrupt, in violation and breach of its bounden duty in the premises, failed, neglected, or refused to turn over said sum to the said Majestic Employees Welfare Association, but retained the said money for its own use and benefit; that thereafter, the said bankrupt continued until on or about to-wit: August 12, 1933, to make weekly deductions from the salary or wages of its employees so that on said last named date, to-wit: August 12, 1933; the bankrupt had deducted from the wages or salary of its employees, an aggregate sum of Fourteen Thousand Six Hundred Seven Dollars and Fifty One Cents ($14,607.51) all of which sum it failed, neglected or refused to turn over in accordance with is bounden duty so to do, to the Majestic Employees Welfare Association, but retained said sum and all of it for its own use and benefit; that none of said sum of Fourteen Thousand Six Hundred Seven Dol-
[fol. 4] lars and Fifty One Cents ($14,607.51) nor any part of it was turned over to the Majestic Employees Welfare Association but, on the contrary, the said bankrupt tortiously and wrongfully and fraudulently retained the said sum and all of it in its own possession and control; that on or about to-wit: August 12, 1933, the said Majestic Employees Welfare Association was dissolved and disbanded, and by apt resolution of the Board of Directors of the said association, the assets of said association were duly transferred and assigned to an organization prior thereto duly organized, commonly known as the "Works Council";

That said Works Council was an unincorporated organization, the membership of which was composed of duly elected representatives of the management of the bankrupt

and of the employees; that said Works Council, under its charter and by-laws, conferred certain recreational and social benefits upon the employees of the bankrupt;

That the assets of said association consisted in part of high grade securities of a face value of approximately Eighteen Thousand Dollars ($18,000.00), Three Thousand Dollars ($3,000.00) in cash and a sum of Fourteen Thousand Six Hundred Seven Dollars and Fifty One Cents ($14,607.51) due and owing from the bankrupt;

That said securities were thereafter liquidated by said Works Council and, by apt resolution, the proceeds thereof together with the aforementioned sum of approximately Three Thousand Dollars ($3,000.00) in cash, were prorated and distributed among the employees of the bankrupt;

That, notwithstanding the fact that the officers and representatives of said Works Council had made numerous requests and demands on said bankrupt to turn over the said sum of Fourteen Thousand Six Hundred Seven Dollars and Fifty One Cents ($14,607.51), the bankrupt, while acknowledging and admitting its obligation and liability on that behalf, failed so to do so that the said sum of Fourteen Thousand Six Hundred Seven Dollars and Fifty One Cents ($14,607.51) was not available for proration and distribution to the employees rightfully entitled thereto;

That said sum of Fourteen Thousand Six Hundred Seven Dollars and Fifty One Cents ($14,607.51) appears as an indebtedness of the bankrupt on the books and records of said bankrupt as due and owing to the Majestic Employees Welfare Association; that said bankrupt has, at all times, admitted and acknowledged said indebtedness due, and has, at all times, acknowledged, assented to, and accepted the [fol. 5] assignment of said sum from the Majestic Employees Welfare Association to the Works Council as hereinabove described;

That the beneficiaries of said fund are all former employees of the bankrupt; that said beneficiaries are very numerous, totalling approximately three thousand (3,000); that your Petitioner prays to be excused from setting forth in this Petition, the names of each of said beneficiaries, but is ready, upon the hearing of this cause, to produce a complete list of said beneficiaries;

That on to-wit: the 24th day of November A. D. 1933, Receivers in Equity were appointed for said bankrupt; that

thereafter duly authorized representatives of said Works Council requested said Receivers to turn over to said Works Council the sum of Fourteen Thousand Six Hundred Seven Dollars and Fifty One Cents ($14,607.51), but said request was not granted;

That on or about the 22nd day of February A. D. 1934, the following resolution was unanimously adopted by the members of said Works Council:

"The amount due the Majestic Works Council for their administration for the benefit of employees whom they represent, said fund being the property of the Works Council as successor to the Majestic Employees Welfare Asociation is $14,607.51, as indicated on the statement of the Treasurer, which is hereby approved.

Therefore it is hereby resolved that we as elected representatives of Majestic employees, totalling approximately 3,000 on August 5, 1933, the date of the creation of this Council as successor to the Majestic Employees Welfare Association, elect and appoint Mr. M. E. Paradise, our Chairman, as sole trustee of the Benefit Fund totalling $14,607.51, and hereby authorize him to bend every effort, with the aid of such legal counsel as he may require, and subject to such expenses of court or legal counsel as he may approve, to collect said sum due this Council by Grigsby-Grunow Company, and as entered on claim for said amount submitted to Equity Receivers of Grigsby-Grunow Company, Thomas L. Marshall and LeRoi J. Williams.

It is further resolved that as quickly as our Trustee Mr. Paradise, can collect said fund that the total amount resulting from this claim against Grigsby-Grunow Company, less such amount as may be authorized by the Trustee for expense incurred in this collection, shall be pro-rated [fol. 6] equally to all employees of Grigsby-Grunow Company as of August 5, 1933."

That pursuant to said resolution, this Petitioner, Maurice Paradise, prays leave as Trustee for the benefit of said employees of the bankrupt, to file this, his Petition, for a Preferred Claim against the Estate of the said bankrupt, and further asks that said claim in the sum of Fourteen Thousand Six Hundred Seven Dollars and Fifty One Cents ($14,607.51) be allowed as a Preferred Claim against the Bankrupt Estate herein;

That there are no set-offs or counter-claims to the same and that this Petitioner has not, nor has any person by his

order or to his knowledge and belief, had or received any manner of security for said debt whatever.

Maurice Paradise, Trustee.

Subscribed and sworn to before me this 27th day of June, A. D. 1934. Katherine Kelly, Notary Public.

IN THE DISTRICT COURT OF THE UNITED STATES

* * * (Caption—55173) * * *

POWER OF ATTORNEY

To Stanford Clinton, 134 N. LaSalle Street, Chicago, Illinois:

I, Maurice Paradise, as Trustee, of the City of Chicago, County of Cook, and State of Illinois, do hereby authorize you to attend the meetings of creditors of the bankrupt aforesaid at a court of bankruptcy, wherever advertised or directed to be holden, on the day and at the hour appointed and notified by said court in said matter, or at such other place and time as may be appointed by the court for holding such meeting or meetings, or at which such meeting or meetings, or any adjournment or adjournments thereof may be held, and then and there from time to time, and as often as there may be occasion, for me and in my name to vote for or against any proposal or resolution that may be then submitted under the acts of Congress relating to bankruptcy; and in the choice of trustee or trustees of the estate of the said bankrupt, and for me to assent to such [fol. 7] appointment of trustee; and with like powers to attend and vote at any other meeting or meetings of creditors, or sitting or sittings of the court, which may be held therein for any of the purposes aforesaid; also to accept any composition proposed by said bankrupt in satisfaction of his debts, and to receive payment of dividends and of money due me under any composition, and for any other purpose in my interest whatsoever, with full power of substitution.

In Witness Whereof, I have caused these presents to be signed this 27th day of June A. D. 1934.

Maurice Paradise, Trustee.

Subscribed and sworn to before me this 27th day of June A. D. 1934. Katherine Kelly, Notary Public.

IN UNITED STATES DISTRICT COURT

* * * (Caption—55173) * * *

ANSWER OF FRANK M. McKEY, TRUSTEE TO THE PETITION OF MAURICE PARADISE FOR ALLOWANCE OF PREFERRED CLAIM IN THE SUM OF $14,607.51—Filed July 27, 1934

To the Honorable Edmund D. Adcock, Referee in Bankruptcy:

Now comes Frank M. McKey, the duly elected, qualified and acting Trustee in Bankruptcy of Grigsby-Grunow Company, a corporation, the bankrupt herein, and for answer to the petition of Maurice Paradise, says as follows:

Your trustee admits that on to-wit: the 4th day of February, 1933, and prior thereto the Grigsby-Grunow Company, a corporation, maintained in connection with its business and for the benefit of its employees an organization known as "Majestic Employees Welfare Association"; that the purpose and object of said Association was to provide certain insurance and health benefits for the employees of [fol. 8] said Grigsby-Grunow Company and that to obtain the benefit and advantage of the protection and insurance of said Majestic Employees Welfare Association there was deducted from the salary or wages of each employee of the Grigsby-Grunow Company, a corporation, the sum of $.25 per week.

Your trustee for further answer is without information and, therefore, neither admits nor denies that upon the deduction of said sum, the Grigsby-Grunow Company, a corporation, had obligated itself by the terms and provisions of the charter, constitution and by-laws of said Majestic Employees Welfare Association to turn over immediately the aggregate of said deductions from the salary or wages of said employees to the Majestic Employees Welfare Association, but states upon information and belief that the amount so deducted by the Grigsby-Grunow Company, a corporation, from the salary or wages of said employees was credited on its books of account to the account of the Majestic Employees Welfare Association and that periodical payments were made from time to time by the Grigsby-Grunow Company, a corporation, to the Majestic Employees Welfare Association to cover said collections, less

any expenses incurred by the Association that were paid for by the Grigsby-Grunow Company, a corporation.

Your trustee for further answer is without information and, therefore, neither admits nor denies that said Association was thereupon to invest and reinvest the moneys thus acquired and accumulated in certain sound securities, more specifically specified in said constitution and by-laws of said Association, to the end that the interest or other increment earned by said investments would be available for the insurance and health benefits contemplated in the organization of said Association, but prays that the petitioner be required to make strict proof thereof.

Your trustee for further answer denies that on or about to-wit: February 4, 1933 the Grigsby-Grunow Company, a corporation, deducted certain large sume of money from the wages or salaries of its employees and denies that the Grigsby-Grunow Company, a corporation, in violation and breach of its alleged bounded duty in the premises failed, neglected or refused to turn over said sum to the said Majestic Employees Welfare Association and denies that it retained the said moneys for its own use and benefit.

Your trustee for further answer admits that from April 22, 1933 to and including August 12, 1933 the Grigsby- [fol. 9] Grunow Company, a corporation, deducted from the salaries or wages of its employees who were members of said Majestic Employees Welfare Association the sum of $14,756.42 and for the period commencing February 4, 1933 and expiring November 4, 1933, the Grigsby-Grunow Company, a corporation, expended on behalf of said Majestic Employees Welfare Association the net sum of $148.91 and the amounts so deducted from the salaries or wages of said employees, less the amount of the charges, were credited upon the books and records of the bankrupt corporation to the account of the Majestic Employees Welfare Association.

Your trustee for further answer denies that the Grigsby-Grunow Company, a corporation retained the said sum of $14,607.51 for its own use and benefit but states the fact to be that no fund ever existed or any segregation was made of the same but that the said balance of $14,607.51 was merely a bookkeeping computation which was arrived at by deducting the said sum from the amounts due to its

employees and crediting the same upon its books to the credit of the Majestic Employees Welfare Association.

Your trustee for further answer admits that the Grigsby-Grunow Company, a corporation, never paid or turned over to the Majestic Employees Welfare Association the amount of $14,607.51 or any part thereof, but denies that the Grigsby-Grunow Company, a corporation, tortiously, wrongfully and fraudulently retained said amount in its own possession and control.

Your trustee for further answer admits that on or about to-wit: August 12, 1933 the said Majestic Employees Welfare Association was dissolved and disbanded but is without information and, therefore, neither admits nor denies that by apt resolution of the Board of Directors of said Association the assets of said Association were duly transferred and assigned to an organization prior thereto duly organized, commonly known as the "Works Council" but prays that the petitioner be required to make strict proof thereof.

Your trustee for further answer admits that the Works Council was an unincorporated organization, the membership of which was composed of duly elected representatives of the management of the Grigsby-Grunow Company, a corporation, and of its employees and that said Works Council under its charter and by-laws conferred certain recreational and social benefits upon the employees of the Grigsby-Grunow Company, a corporation.

[fol. 10] Your trustee for further answer is without information and, therefore, neither admits nor denies that the assets of said Association consisted in part of high grade securities of a face value of approximately $18,000.00, $3,000.00 in cash and a claim against the Grigsby-Grunow Company, a corporation, of $14,607.50, which was due and owing from the Grigsby-Grunow Company, a corporation, to said Majestic Employees Welfare Association.

Your trustee for further answer is without information and, therefore, neither admits nor denies that said securities were thereafter liquidated by said Works Council and by apt resolution, the proceeds thereof, together with the aforementioned sum of approximately $3000.00, were prorated and distributed among the employees of the Grigsby-Grunow Company, a corporation, but prays that the petitioner be required to make strict proof thereof.

Your trustee for further answer is without information and, therefore, neither admits nor denies that the officers and representatives of said Works Council had made numerous requests and demands on said Grigsby-Grunow Company, a corporation, to turn over the said sum of $14,607.51 as alleged in said petition but prays that the petitioner be required to make strict proof thereof.

Your trustee for further answer admits that the said sum of $14,607.51 appears as an indebtedness of the Grigsby-Grunow Company, a corporation, on its books and records, as due and owing to the Majestic Employees Welfare Association but is without information and, therefore, neither admits nor denies that said Grigsby-Grunow Company, a corporation, has at all times admitted and acknowledged said indebtedness due, and has at all times acknowledged, assented to, and accepted the assignment of said sum from the Majestic Employees Welfare Association to the Works Council but prays that the petitioner be required to make strict proof thereof.

Your trustee for further answer is without information and, therefore, neither admits nor denies that the beneficiaries of said Majestic Employees Welfare Association are all former employees of Grigsby-Grunow Company, a corporation; are very numerous, totaling approximately 3000, but prays that the petitioner be required to make strict proof thereof.

Your trustee for further answer is without information and, therefore, neither admits nor denies that the duly authorized representatives of said Works Council re- [fol. 11] quested the equity receivers of the Grigsby-Grunow Company, a corporation, to turn over to it the sum of $14,607.51 and that said request was not granted, but prays that the petitioner be required to make strict proof thereof.

Your trustee is without information and, therefore, neither admits nor denies that on or about the 22nd day of February, 1934 the resolution as set forth in said petition was unanimously adopted by members of the Works Council, but prays that the petitioner be required to make strict proof thereof.

Your trustee for further answer alleges that nothing in said petition contained is sufficient under the terms and provisions of the Bankruptcy Act to establish the right in said petitioner to a preferred claim against this estate, but on the contrary, and if the petitioner is legally entitled

to prove a claim in this estate, that the same would be in the nature of a general claim and one not entitled to priority of payment.

Your trustee for further answer alleges that the claim of said petitioner as set forth in his said petition does not come within any of the provisions of the Bankruptcy Act and particularly Section 64 thereof and is, therefore, one not entitled to priority of payment.

Your trustee having fully answered said petition prays that the petition of Maurice Paradise filed in this cause on the 29th day of June, A. D. 1934, be dismissed or in lieu thereof that said petition should be allowed to stand as a general unsecured claim against this estate.

Frank M. McKey, Trustee.

Duly sworn to by Frank M. McKey. Jurat omitted in printing.

[fol. 12] In United States District Court

• • • (Caption—55173) • • •

Stipulation of Facts—Filed October 16, 1934.

It Is Hereby Stipulated and Agreed by and between Frank M. McKey, as Trustee of the bankrupt estate of Grigsby-Grunow, Inc., and Maurice Paradise, as Trustee, petitioner herein, by their respective counsel, that the facts relevant to the petition filed herein on behalf of said Maurice Paradise, as Trustee, are as follows:

On February 4, 1933 and prior thereto, the bankrupt maintained in connection with its business, an unincorporated organization known as the "Majestic Employees Welfare Association, which had been formerly known as the "Majestic Employees Welfare and Athletic League." The Association's purpose was to provide life, health and accident insurance for the benefit of the employees of the bankrupt and their dependents. The Association was governed by its own officers and directorate and maintained its own account in the First National Bank of Chicago. The funds of the Association were invested exclusively in obligations of the United States Government and the earnings and increment of these investments were used for the insurance benefits contemplated by the Association's constitution and by-laws.

The membership of the Association was comprised exclusively of employees who had been employed for thirty days or more and who had paid the initial fee of $1.00 to the treasury of the Association. The initial fee was automatically deducted by the bankrupt from the amount due as salary or wages of each employee, employed for the required period. In addition to the initial fee there were weekly dues of 25c per week, which were likewise automatically deducted by the bankrupt from the amount due each member as salary or wages.

Prior to February 4, 193-, the bankrupt regularly paid the Association by check which was deposited in its treasury, the accumulations of each payroll deduction, less de- [fol. 13] ductions for expenses of the Association paid by the bankrupt. Commencing with February 4, 1933, however, the bankrupt began to fall in arrears, and from that time until November 24, 1933, when the Receivers in Equity were appointed for the bankrupt, there was always a balance to the credit of the Association, which it had not paid to the Association. On November 24, 1933 said balance was in the sum of $14,607.51. The deductions of 25c per week, including deduction for the initial fee, were made by charging the employee's account on the payroll records of the bankrupt and crediting the aggregate of all such deductions to the account of the Majestic Employees Welfare Association on the books of the bankrupt. No actual money was taken from the pay envelopes of the employees and deposited in any account of the bankrupt, but to the contrary the matter was handled as a mere bookkeeping entry and at no time did the Grigsby-Grunow Company segregate any money due the Majestic Employees Welfare Association or deposit any money in any separate trust account or bank account.

On or about August 12, 193-, the Majestic Employees Welfare Association was formally dissolved and disbanded. At the time of the dissolution the Association had the following assets:

Cash (including moneys due from Grigsby-Grunow, Inc.)	$19,607.51
United States Government Bonds	18,000.00
Total	$37,607.51

After setting up a fund of some $2,750.00 to cover certain contingent obligations of the Association, all the other

assets were conveyed, by apt resolution, to the Majestic Works Council. The Works Council, like the Association, was an unincorporated organization in which the bankrupt and its employees had equal representation. All employees of the bankrupt were members of the Works Council. The Works Council had for its objective harmonious relations between the bankrupt and its employees and conferred numerous benefits upon the employees.

On December 19, 1933, the Board of Directors of the Works Council adopted a resolution to disburse some $20,000.00 of the moneys which had been assigned to the Council by the Association. In accordance with this resolution, the moneys were thereafter disbursed pro ratably to the [fol. 14] employees. A claim was filed in the equity receivership case by Maurice Paradise, as Trustee, the petitioner herein, for the payment of the $14,607.51 to the Works Council. However, the moneys were never paid.

On February 22, 1934, the following resolution was adopted by the Works Council:

"The amount due the Majestic Works Council for their administration for the benefit of employees whom they represent, said fund being the property of the Works Council, as successor to the Majestic Employees Welfare Association, is $14,607.51, as indicated on the statement of the Treasurer, which is hereby approved;

"Therefore, it is hereby resolved that we, as elected representatives of Majestic employees, totalling approximately 3,000 on August 5, 1933, the date of the creation of this Council as successor to the Majestic Employees Welfare Association, elect and appoint Mr. M. E. Paradise, our Chairman, as sole trustee of the Benefit Fund totalling $14,607.51, and hereby authorize him to bend every effort, with the aid of such legal counsel as he may require, and subject to such expenses of court or legal counsel as he may approve, to collect said sum due this Council by Grigsby-Grunow Company, and as entered on claim for said amount submitted to Equity Receivers of Grigsby-Grunow Company, Thomas L. Marshall and Le Roi J. Williams.

"It is further resolved that as quickly as our Trustee, Mr. Paradise, can collect said fund, that the total amount resulting from this claim against Grigsby-Grunow Company, less such amount as may be authorized by the Trustee for expense incurred in this collection, shall be pro rated equally to all employees of Grigsby-Grunow Company as of August 5, 1933."

In conformity with this direction and authorization, this proceeding was instituted. Subsequent to February 4, 1933, when the Company began to fall in arrears, Maurice Paradise, petitioner herein, who was the Manager of the Majestic Employees Welfare Association and Chairman of the Board of the Works Council, on several occasions spoke to LeRoi J. Williams, Vice-President and General Manager of the bankrupt, and to M. D. Harrison, Treasurer of the Company, and requested the payment of the sums which the bankrupt was obligated to pay over to the Association. However, Mr. Paradise was unsuccessful in straightening the matter out. On one occasion the request for payment of the money, as evidenced by a voucher, was forwarded to [fol. 15] the Treasurer's office for signature and the same was returned unsigned. It appears that Mr. Paradise also requested payment from the Equity Receivers and payment was refused.

The practice of the bankrupt was to deposit all of its incoming revenue in its general bank account, from which it would from time to time withdraw moneys and establish various special accounts. The bankrupt was accustomed to withdraw from its general account or special accounts as the convenience of the situation required, and the payroll was drawn from the various accounts, both general and special, indiscriminately.

On November 24, 1933, the bank balances of the bankrupt were as follows:

	Bank Balance	Checks Outstanding	Book Balance
Continental Illinois National Bank and Trust Company—General Account Used for accounts payable disbursements	$91,016.18	$51,631.70	$39,384.48
Continental Illinois National Bank and Trust Company—Special Account Used for office payroll	9,613.16	6,554.26	3,058.90
Harris Trust and Savings Bank Used for temporary payroll and traveling expense disbursements	10,399.66	2,478.58	7,921.08
Bank of Montreal—Canada Deposit account only	256.62	.....	256.62
Pioneer Trust and Savings Bank—General Account Accommodation deposit account	1,005.30	.....	1,005.30
Pioneer Trust and Savings Bank—Payroll Account Used for factory payroll	620.40	.....	620.40
First National Bank—Payroll Account Used for factory payroll	927.52	6.62	920.90
First National Bank—Regular Account Accommodation deposit account	7,031.85	.....	7,031.85
American National Bank	.69	.....	.69

On May 20, 1933, the general account of the bankrupt in the Continental Illinois National Bank and Trust Company of Chicago showed a balance in the sum of $6,071.53, and on September 23, 1934, the balance was $4,305.30. However, at all times from February 4, 1933 to November 24, 1933, there were sufficient moneys in the various accounts to cover the amount of the claim.

A. L. Schapiro, Attorneys for the Trustee in Bankruptcy. Pritzker & Pritzker, Attorneys for Maurice Paradice, as Trustee, Petitioner. Of Counsel: —— ——.

[fol. 16] In United States District Court

• • • (Caption—55173) • • •

Order Authorizing Trustee to Pay Preferential Lien etc.—Entered December 14, 1934.

This cause coming on to be heard upon the petition of Maurice Paradise, as Trustee, for the allowance of a preferential claim against the estate of the bankrupt, and the answer to said petition filed by the Trustee in Bankruptcy; and the court having heard evidence with reference to said petition; and the parties having heretofore entered into a formal stipulation of facts relevant to said petition; and the court having heard the arguments of counsel and read the briefs filed by the respective parties hereto, and being now fully advised in the premises,

The Court Finds as Follows:

(1) The court has jurisdiction of the parties and of the subject matter and jurisdiction to determine this suit.

(2) The accumulated deductions from the wages and salaries of the employees of the bankrupt in sum of $14,607.51, constituted a trust fund in the hands of the bankrupt.

(3) The retention by the bankrupt of the accumulated deductions from the wages and salaries of its employees was tortious and constituted a conversion.

(4) The assets of the bankrupt in the hands of the Trustee in Bankruptcy were augmented and increased to the extent and in the amount of the trust fund.

(5) The trust fund, while co-mingled with the individual funds of the bankrupt, can be sufficiently identified to impress a trust and preferential lien upon all moneys in the bankrupt's bank accounts. Title to the trust fund did not pass to the Trustee in Bankruptcy and may be reclaimed by the beneficiaries or their duly authorized representative.

(6) Maurice Paradise, in the capacity of Trustee, is entitled to recover the full amount of the trust fund.

It Is Therefore Ordered that the petition of Maurice Paradise, as Trustee, for the allowance of a preferential lien against the assets of the bankrupt estate of Grigsby-Grunow, Inc., in the sum of $14,607.51, be and the same is hereby allowed, and It Is Further Ordered that the Trustee [fol. 17] in Bankruptcy pay over to said Maurice Paradise, as Trustee, the said sum of $14,607.51, said payment to be made forthwith.

Enter:

Edmund D. Adcock, Referee in Bankruptcy.

December 14, 1934.

Referee's certificate to foregoing paper omitted in printing.

[fol. 18] IN UNITED STATES DISTRICT COURT

* * * (Caption—55173) * * *

CERTIFICATE OF EDMUND D. ADCOCK, REFEREE IN BANKRUPTCY, PURSUANT TO PETITION FILED BY FRANK McKEY, TRUSTEE IN BANKRUPTCY, TO REVIEW ORDER OF REFEREE ENTERED ON DECEMBER 14, 1934.—Filed January 30, 1935.

To the Honorable John P. Barnes, Judge of the District Court of the United States for the Northern District of Illinois, Eastern Division.

Honorable Sir:

Preliminary Statement

This is an involuntary petition in bankruptcy filed February 17, 1934.

June 29, 1934, Maurice Paradise, as Trustee for the benefit of "Majestic Employees Welfare Association," filed his petition, claiming that he was entitled to the payment of $14,607.51 in cash out of the funds in the possession of the Trustee herein and claiming that said fund constituted a trust which came into the custody of said Trustee and in equity belonged to said Majestic Employees Welfare Association.

An answer was filed by the Trustee on July 27, 1934, denying that petitioner is entitled to any relief.

Question Involved

The sole question involved is whether the petitioner has a valid prior claim upon the trust fund theory to the fund amounting to $14,607.51 and whether he has traced and identified said fund in the continuous possession of Grigsby-Grunow Company up to the time of bankruptcy and the subsequent receipt by the receiver and trustee herein of said fund.

Summary of the Evidence

A summary of the evidence is set forth in the findings of the order complained of and it is unnecessary here to repeat them.

[fol. 19]

Order Complained Of

The order entered December 14, 1934, upon the evidence above mentioned and complained of here, is set forth in the petition for review and it is unnecessary to here again set it forth, as the petition for review is transmitted herewith.

Documents Transmitted

I am transmitting herewith the following:

1. Petition of Maurice Paradise as Trustee, filed June 29, 1934.
2. Answer of Frank M. McKey, Trustee, filed July 27, 1934.
3. Stipulation of facts filed October 16, 1934.
4. Brief and argument of Trustee in Bankruptcy, filed October 16, 1934.
5. Brief and argument of petition, filed October 16, 1934.
6. Notice of petitioner filed December 14, 1934.

7. Findings of fact and conclusions of law submitted by petitioner and filed December 14, 1934.

8. Notice of motion for leave to file petition for review, filed December 22, 1934.

9. Petition to review Referee's order, filed December 22, 1934.

10. Exhibits referred to in stipulation of facts.

Respectfully submitted. Edmund D. Adcock, Referee in Bankruptcy.

Dated, Chicago, January 29, 1935.

[fol. 20] IN UNITED STATES DISTRICT COURT

* * * (Caption—55173) * * *

MEMORANDUM—Filed March 28, 1935

This matter came on to be heard upon a petition to review an order of the Referee entered on December 14, 1934, wherein he allowed a claim of one Maurice Paradise, as trustee, as a preferred claim.

The court, with considerable reluctance, because his sympathies are with the claimant, has come to a conclusion other than and different from that of the Referee.

The court is of the opinion, first, that there was no trust, and, second, that even if there was a trust, the trust funds have not been traced into the hands of the trustee in bankruptcy.

Accordingly, the prayer of the petition for review will be granted and the order of the Referee of December 14, 1934, will be reversed, and an order to that effect has this day been made.

Barnes, Judge.

March 28, 1935.

IN UNITED STATES DISTRICT COURT

* * * (Caption—55173) * * *

ORDER OR DECREE—Entered March 28, 1935

This matter, having come on to be heard upon the petition for a review of the order of the Referee entered De-

cember 14, 1934, and the court, having considered the arguments and being now fully advised in the premises,

It Is Ordered that the prayer of said petition for review be granted and that said order of the Referee of December [fol. 21] 14, 1934, be, and it is hereby, reversed; and the Referee is ordered and directed to allow the claim of the claimant as a general claim against the bankrupt estate.

Enter:

Barnes, Judge.

In United States District Court

* * * * (Caption—55173) * * *

Assignment of Errors—Filed April 26, 1935

The petitioner, Maurice Paradise, in connection with and in support of his application for leave to appeal the order disallowing his claim as a preferential lien and allowing said claim as a general claim against the bankrupt estate, makes the following assignment of errors:

(1) The court erred in finding as a matter of law that there was no trust relationship between the bankrupt estate and the employees of the bankrupt, represented in this cause by the petitioner, as Trustee.

(2) The court erred in finding as a matter of law that even if there was a trust relationship between the bankrupt and its employees, the trust funds had not been traced into the hands of the Trustee in Bankruptcy.

(3) The court erred in reversing the order of the Referee of December 14, 1934.

Wherefore the petitioner prays that said order of the District Court entered on March 28, 1935, be reversed and that the order of the Referee of December 14, 1934 be affirmed.

Maurice Paradise, As Trustee.

[fol. 22] In United States District Court

* * * (Caption—55173) * * *

Order Allowing Appeal—Entered April 26, 1935

This cause coming on to be heard upon the petition of Maurice Paradise, as Trustee, for leave to appeal the order

entered by this court on March 28, 1935, together with the assignment of errors in support of said application; and the court being now fully advised in the premises,

It Is Hereby Ordered that leave is granted to Maurice Paradise, as Trustee to appeal the order entered by this court on March 28, 1935, to the United States Circuit Court of Appeals for the Seventh Circuit upon the filing of a cost bond in the sum of $250.00. To the entry of the foregoing order the Trustee in Bankruptcy objects and excepts.

Enter:

Barnes, Judge.

In United States District Court

* * * (Caption—55173) * * *

Stipulation Waiving Citation—Filed April 27, 1935

It Is Hereby Stipulated and Agreed by and between the parties hereto, through their respective attorneys, that Frank M. McKey, Trustee in Bankruptcy, waives the issuance and service of a citation in connection with the appeal of Maurice Paradise, as Trustee, from the order entered in [fol. 23] this court on March 28, 1935, and further waives the filing of proof of service of said citation.

It Is Further Stipulated that said appeal shall be prosecuted as though a citation had duly issued out of this court and due service of the same had been made on Frank M. McKey, Trustee in Bankruptcy, and due proof of the service of said citation had been filed herein.

A. L. Schapiro, Attorney for Frank M. McKey, Trustee in Bankruptcy. Pritzker & Pritzker, Attorneys for Maurice Paradise, As Trustee.

Approved: —— ——, Judge.

Date: —— — ——.

In United States District Court

* * * (Caption—55173) * * *

Stipulation in Lieu of Præcipe—Filed April 26, 1935

It Is Hereby Stipulated and Agreed that the following pleadings and papers shall be printed and that the case may be heard on the records as thus constituted:

(1) The petition of Maurice Paradise for a preferential lien.
(2) Answer of Frank M. McKey, Trustee in Bankruptcy.
(3) Stipulation of Facts.
(4) Memoranda opinion of the Referee.
(5) Order of Referee granting preferential lien.
(6) Referee's certificate pursuant to Petition for Review.
(7) Memoranda of the District Judge.
(8) Order of the District Judge reversing the findings of the Referee.
(9) Assignment of Errors.
[fol. 24] (10) Order of the District Judge granting leave to appeal to the United States Circuit Court of Appeals for the Seventh Circuit.

A. L. Schapiro, Attorney for Frank M. McKey, Trustee in Bankruptcy. Pritzker & Pritzker, Attorneys for Maurice Paradise, As Trustee.

Approved: —— ——, United States District Judge.

Date: —— — ——.

Clerk's certificate to foregoing transcript omitted in printing.

[fol. 25] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

C. C. A. No. 5498

In the Matter of GRIGSBY-GRUNOW, INC., Bankrupt

In re Petition of MAURICE PARADISE, as Trustee, for a Preferential Lien Against the Assets of the Bankrupt Estate

PETITION FOR APPEAL TO THE CIRCUIT COURT OF APPEALS—Filed April 27, 1935

To the Honorable The Judges of the United States Circuit Court of Appeals of the First Circuit:

Your Petitioner, Maurice Paradise, as Trustee, being aggrieved by a certain order entered in the above entitled proceeding on the 28th day of March, A. D. 1935, in the

District Court for the Northern District of Illinois, Eastern Division, reversing the order of the Referee allowing the claim of the Petitioner for a Preferential Lien against the assets of the bankrupt estate and directing that said claim be allowed as a general claim, does hereby petition for an appeal to the United States Circuit Court of Appeals for the Seventh Circuit.

Maurice Paradise, As Trustee.

[File endorsement omitted.]

[fol. 26] IN UNITED STATES CIRCUIT COURT OF APPEALS

* * * (Caption—5498) * * *

ASSIGNMENT OF ERRORS—Filed April 27, 1935

The Petitioner, Maurice Paradise, in connection with and in support of his application for leave to appeal the order disallowing his claim as a Preferential Lien and allowing said claim as a general claim against the bankrupt estate, makes the following assignment of errors:

(1) The court erred in finding as a matter of law that there was no trust relationship between the bankrupt estate and the employees of the bankrupt, represented in this cause by the Petitioner, as Trustee.

(2) The court erred in finding as a matter of law that even if there was a trust relationship between the bankrupt and its employees, the trust funds had not been traced into the hands of the Trustee in Bankruptcy.

(3) The court erred in reversing the order of the Referee of December 14, 1934.

Wherefore the petitioner prays that said order of the District Court entered on March 28, 1935, be reversed and that the order of the Referee of December 14, 1934 be affirmed.

Maurice Paradise, As Trustee.

[File endorsement omitted.]

IN UNITED STATES CIRCUIT COURT OF APPEALS

* * * (Caption—5498) * * *

ORDER GRANTING LEAVE TO APPEAL—Filed April 27, 1935

This cause coming on to be heard on the petition of Maurice Paradise, as Trustee, to appeal from an order entered in the United States District Court for the Northern District of Illinois, Eastern Division, on the 28th day of March, 1935; and the court having considered the state-
[fol. 27] ment of the issues and the Assignment of Errors; and the court being now fully advised in the premises.

It Is Ordered that leave be and is hereby granted said Maurice Paradise, as Trustee, to prosecute an appeal to this court from the order entered on March 28, 1935 by the United States District Court for the Northern District of Illinois, Eastern Division, in the cause entitled "In the Matter of Grigsby-Grunow, Inc., Bankrupt," bearing case No. 55173.

Enter:

William M. Sparks, Judge of the United States Circuit Court of Appeals, Seventh Circuit.

[File endorsement omitted.]

IN UNITED STATES CIRCUIT COURT OF APPEALS

* * * (Caption—5498) * * *

ORDER CONSOLIDATING CAUSES, ETC.—Filed April 30, 1935

This cause coming on to be heard on the petition of Maurice Paradise, as Trustee, Petitioner-Appellant herein, to consolidate this cause with the cause bearing Case No. 5499, and

It appearing to the court that both of said causes are identical in parties, subject matter and the relief sought and the court having considered the stipulation of the parties that said causes be consolidated, and

It further appearing to the court that it will greatly simplify and expedite the disposition of said causes to enter an order of consolidation, and the court now being fully advised in the premises,

It Is Hereby Ordered that this cause be and it is hereby [fol. 28] consolidated with Cause No. 5499; that said causes, as consolidated, shall proceed as though they were one and the same appeal and all papers and documents heretofore filed in either of said causes shall be deemed to have been filed in each of said causes, and

It Is Further Ordered that all orders, findings or judgments of this court entered in said consolidated causes shall be binding upon the parties as though said orders, findings or judgments were separately entered in each of said causes.

[File endorsement omitted.]

[fols. 29 & 30] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 31] [Caption omitted]

IN UNITED STATES CIRCUIT COURT OF APPEALS, SEVENTH CIRCUIT

In the Matter of GRIGSBY-GRUNOW, INC., Bankrupt

5498

MAURICE PARADISE, as Trustee,

vs.

FRANK M. McKEY, Trustee in Bankruptcy

Appeal from the District Court of the United States for the Northern District of Illinois, Eastern Division

In the Matter of GRIGSBY-GRUNOW, INC., Bankrupt

5499

MAURICE PARADISE, as Trustee

vs.

FRANK M. McKEY, Trustee in Bankruptcy

Appeal from the District Court of the United States for the Northern District of Illinois, Eastern Division

MEMO RE PETITION FOR APPEAL

And afterwards, to-wit: On the twenty-seventh day of April, 1935, there was filed in the office of the Clerk of this

court, in cause No. 5498, a Petition for Leave to Appeal, which said Petition is not copied here, as the same appears on page 25 of the printed record in this cause, certified herewith.

MEMO RE ASSIGNMENTS OF ERROR

And on the same day, to-wit: On the twenty-seventh day of April, 1935, there was filed in the office of the Clerk of this court, in cause No. 5498, an Assignment of Errors, which said Assignment of Errors is not copied here, as the same appears on page 26 of the printed record in this cause, certified herewith.

[fol. 32] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

No. 5498

[Title omitted]

STATEMENT OF ISSUES—Filed April 27, 1935

The Petitioner, Maurice Paradise, as Trustee, for the benefit of approximately three thousand (3,000) former employees of the bankrupt, filed his petition asking for a Preferential Lien against the bankrupt estate. The matter was heard upon a Stipulation of Facts.

The bankrupt had entered into an agreement with its employees whereby it deducted twenty-five cents (25c) for a week from the pay roll or salary of each employee and undertook to remit the accumulated deductions to the Majestic Employees Welfare Association. The monies thus remitted were to be invested in obligations of the United States Government and the income derived therefrom were to provide health, accident and life insurance benefits for the employees of the bankrupt.

The bankrupt had failed to turn over the sum of Fourteen Thousand Six Hundred Seven Dollars and Fifty-one Cents ($14,607.51) of the monies it had deducted from the salaries and wages due its employees in accordance with its agreement.

The Petitioner claims that he has a Preferential Lien against the assets of the bankrupt in that amount. The

Trustee in Bankruptcy contends that there was no trust relationship between the bankrupt and its employees and that even assuming the existence of such a trust relationship, it is impossible for the petitioner to sufficiently identify and trace the funds.

The Referee, after hearing the matter, entered an order [fol. 33] allowing the Petitioner a Preferential Lien. The Trustee in Bankruptcy filed his Petition for Review to the District Court. The District Judge reversed the order of the Referee allowing the claimant a Preferential Lien and directed that the Petitioner's claim be allowed as a general claim against the estate.

There are two questions:

1. Was there a trust relationship between the bankrupt and its employees?

2. Assuming the existence of the trust relationship between the bankrupt and its employes, can the trust fund be traced and identified?

Maurice Paradise, As Trustee.

[File endorsement omitted.]

MEMO RE ORDER GRANTING LEAVE TO APPEAL

And on the same day, to-wit: On the twenty-seventh day of April, 1935, an Order was entered in cause No. 5498, Granting Leave to Appeal, which said Order is not copied here as the same appears on pages 26 & 27 of the printed record in this cause, certified herewith.

[fol. 34] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

No. 5498

[Title omitted]

APPEARANCE OF COUNSEL—Filed April 27, 1935

The Clerk will enter my appearance as counsel for Appellant.

Stanford Clinton, 134 North La Salle St., Chicago, Illinois.

[File endorsement omitted.]

IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

No. 5498

[Title omitted]

PETITION TO CONSOLIDATE—Filed April 30, 1935

Your Petitioner, Maurice Paradise, as Trustee, respectfully represents unto this Honorable Court that he is the appellant in the above entitled cause and that he is also the [fol. 35] appellant in the cause bearing Case No. 5499, which is also pending in this court.

Your Petitioner further represents that this cause is identical in respect to parties, subject matter and the relief sought as in the cause bearing Case No. 5499; that both of said appeals seek to review the identical order entered by the District Court on the 28th day of March, A. D. 1935; that your petitioner has prosecuted these two appeals due to the fact that he was in doubt as to whether the appeal should be taken under Section 47 or Section 48, Title 11, of the United States Code.

Your Petitioner further represents that it will greatly simplify, and expedite said appeals, if this cause be consolidated with Case No. 5499.

Wherefore, your Petitioner respectfully prays this Honorable Court for an order consolidating this cause with Case No. 5499 and that the record in Cause No. 5499 be treated as the record in this cause; that said causes, as consolidated, shall proceed as though they were one appeal and the orders, findings or judgments of this court shall be binding upon the parties, and have the same effect, as though said orders and judgments were separately entered in each of said causes.

And your Petitioner will every pray, etc.

Maurice Paradise, as Trustee, by Stanford Clinton,
His duly authorized agent.

Duly sworn to by Stanford Clinton. Jurat omitted in printing.

[File endorsement omitted.]

[fol. 36] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

No. 5498

[Title omitted]

STIPULATION TO CONSOLIDATE—Filed April 30, 1935

It is hereby stipulated and agreed by and between the parties hereto, by their respective attorneys, that an order be entered herein consolidating this cause with the cause pending in this court bearing Case No. 5499; that said causes, as consolidated, shall proceed as though they were one and the same appeal; that the record heretofore filed in Cause No. 5499 shall be treated as the record in said consolidated causes and shall be binding upon the parties, as though said record was filed separately in each of said causes and that all the orders, findings or judgments of the court which shall hereafter be entered in said causes, as consolidated, shall be binding upon the parties and be of the same effect as though said orders, findings or judgments were separately entered in said causes.

A. L. Schapiro, Attorney for Frank McKey, Trustee in Bankruptcy, Respondent-Appellee. Stanford Clinton, Pritzker & Pritzker, Attorneys for Maurice Paradise, as Trustee, Petitioner-Appellant.

[File endorsement omitted.]

[fol. 37] MEMO RE ORDER CONSOLIDATING CAUSES

And on the same day, to-wit: On the thirtieth day of April, 1935, an Order was entered Consolidating Cause No. 5498 with Cause No. 5499, which said Order is not copied here, as the same appears on pages 27 & 28 of the printed record in this cause, certified herewith.

IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Nos. 5498-5499

[Title omitted]

APPEARANCE OF COUNSEL—Filed May 1, 1935

The Clerk will enter my appearance as counsel for Appellee.

A. L. Schapiro, 33 So. Clark St., Chicago, Illinois.

[File endorsement omitted.]

[fol. 38] Minute entry of argument and submission, Oct. 8, 1935, omitted in printing.

[fol. 39] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Consolidated Nos. 5498-5499

[Title omitted]

STIPULATION RE CLAIM OF APPELLANT—Filed Nov. 25, 1935

It Is Hereby Stipulated and Agreed by and between Maurice Paradise, as Trustee, appellant, and Frank M. McKey, Trustee in Bankruptcy, appellee, the parties to this appeal, by their respective attorneys, that no part of the $14,607.51 claimed by the appellant represents wages earned within three months before the date of the commencement of court proceedings.

Stanford Clinton, Attorney for Appellant. A. L. Schapiro, Attorney for Appellee.

[File endorsement omitted.]

[fol. 40] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT, OCTOBER TERM, 1935, OCTOBER SESSION, 1935

Nos. 5498 and 5499

In the Matter of GRIGSBY-GRUNOW, INC., Bankrupt

MAURICE PARADISE, as Trustee, Appellant,

vs.

FRANK M. MCKEY, Trustee in Bankruptcy, Appellee

Appeals from the District Court of the United States for the Northern District of Illinois, Eastern Division

Before Evans and Sparks, Circuit Judges, and Briggle, District Judge

OPINION—Filed December 7, 1935

EVANS, Circuit Judge:

These appeals were taken from an order entered in the Grigsby-Grunow bankruptcy proceedings which disallowed preference to a claim presented by the trustee of an employees' welfare association, appellant herein. Bankrupt, prior to its adjudication, employed three thousand persons. They all belonged to an association which had for its objective the development of harmonious relations between bankrupt and its employees and the providing of accident and health insurance for the latter. Bankrupt charged each employee a membership fee of one dollar and deducted twenty-five cents each week from the employee's wage. These sums, after certain expense deductions, were turned over to the association to be invested solely in United States Government bonds and to be used for the aforementioned purposes. Bankrupt deducted the twenty-five cents per week from the wages of each of its employees and charged itself with the said amount and at the same time turned the money over to the welfare association. This practice was [fol. 41] followed for some time, but, after February 4, 1933, it neglected to pay all of the funds which it deducted from the wages of its employees to the treasury of the wel-

fare association. When the petition in bankruptcy was filed, it held $14,607.51 of such moneys.

The referee to whom the matter was referred made findings upon which he allowed the claim as a preferential lien against the assets of the estate. On review, the District Court reversed this order and appellant's claim was allowed as a general, but not as a preferred claim.

We quote from the findings of the referee, which are not attacked:

"On February 4, 1933 and prior thereto, the bankrupt maintained in connection with its business, an unincorporated organization known as the 'Majestic Employees Welfare Association,' which had been formerly known as the 'Majestic Employees Welfare and Athletic League.' The Association's purpose was to provide life, health and accident insurance for the benefit of the employees of the bankrupt and their dependents. The Association was governed by its own officers and directorate and maintained its own account in the First National Bank of Chicago. The funds of the Association were invested exclusively in obligations of the United States Government and the earnings and increment of these investments were used for the insurance benefits contemplated by the Association's constitution and by-laws.

"The membership of the Association was comprised exclusively of employees who had been employed for thirty days or more and who had paid the initial fee of $1.00 to the treasury of the Association. The initial fee was automatically deducted by the bankrupt from the amount due as salary or wages of each employee, employed for the required period. In addition to the initial fee there were weekly dues of 25c per week, which were likewise automatically deducted by the bankrupt from the amount due each member as salary or wages.

"Prior to February 4, 1933, the bankrupt regularly paid the Association by check which was deposited in its treasury, the accumulations of each payroll deduction, less deductions for expenses of the Association paid by the bankrupt. Commencing with February 4, 1933, however, the bankrupt began to fall in arrears, and from that time until November 24, 1933, when the Receivers in Equity were [fol. 42] appointed for the bankrupt, there was always a balance to the credit of the Association, which it had not

paid to the Association. On November 24, 1933 said balance was in the sum of $14,607.51. The deductions of 25c per week, including deduction for the initial fee, were made by charging the employee's account on the payroll records of the bankrupt and crediting the aggregate of all such deductions to the account of the Majestic Employees Welfare Association on the books of the bankrupt. No actual money was taken from the pay envelopes of the employees and deposited in any account of the bankrupt, but to the contrary the matter was handled as a mere bookkeeping entry and at no time did the Grigsby-Grunow Company segregate any money due the Majestic Employees Welfare Association or deposit any money in any separate trust account or bank account.

"On or about August 12, 1933, the Majestic Employees Welfare Association was formally dissolved and disbanded. • • •

"After setting up a fund of some $2,750.00 to cover certain contingent obligations of the Association, all the other assets were conveyed, by apt resolution, to the Majestic Works Council. The Works Council, like the Association, was an unincorporated organization in which the bankrupt and its employees had equal representation. All employees of the bankrupt were members of the Works Council. The Works Council had for its objective harmonious relations between the bankrupt and its employees and conferred numerous benefits upon the employees.

"• • • A claim was filed in the equity receivership case by Maurice Paradise, as Trustee, the petitioner herein, for the payment of $14,607.51 to the Works Council. However, the moneys were never paid. • • •

"The practice of the bankrupt was to deposit all of its incoming revenue in its general bank account, from which it would from time to time withdraw moneys and establish various special accounts. The bankrupt was accustomed to withdraw from its general account or special accounts as the convenience of the situation required, and the payroll was drawn from the various accounts, both general and special, indiscriminately."

[fol. 43] Whether a constructive trust was created in appellant's favor must be determined by the legal effect of

the bankrupt's acts. The following, taken from the stipulated facts, is well-nigh controlling:

"* * * In addition to the initial fee there were weekly dues of 25¢ per week, which were likewise automatically deducted by the bankrupt from the amount due each member as salary * * *.

"Prior to February 4, 1933, the bankrupt regularly paid the Association by check which was deposited in its treasury, the accumulations of each payroll deduction, less deductions for expenses of the Association paid by the bankrupt. Commencing with February 4, 1933, however, the bankrupt began to fall in arrears, and from that time until November 24, 1933, when the Receivers in Equity were appointed for the bankrupt, there was always a balance to the credit of the Association, which it had not paid to the Association. On November 24, 1933, said balance was in the sum of $14,607.51. The deductions of 25¢ per week, including deduction for the initial fee, were made by charging the employees' account on the payroll records of the bankrupt and crediting the aggregate of all such deductions to the account of the Majestic Employees Welfare Association *on the books of the bankrupt.*"

Such transactions, we think, resulted in the creation of a trust, a constructive trust, a trust ex maleficio, which was fastened upon the bankrupt irrespective of its intention. When it deducted the twenty-five cents per week and the one dollar initiation fee, it was under obligation to turn the same over to the Majestic Employees Welfare Association. This it did for several years. But, with failure and bankruptcy confronting it, resort was had, as is so frequently the case, to subterfuge—to an attempt to despoil or dispossess those whose numbers were many and whose individual interests were small. Instead of turning over to the welfare association the money deducted from the employees' wages, the bankrupt converted it to its own use. It credited itself with the payment of the amount and yet retained the said sum in its own treasury. This was a conversion.

The turning point in the case is the transaction whereby bankrupt, indebted to individual employees for wages, took the same and satisfied its indebtedness to them and then [fol. 44] failed to turn the money over to the beneficiary.

Bankrupt's right to credit itself with the unpaid wages was dependent upon its payment of said sum to the welfare association.

What bankrupt did was to take the money, the amount of which was the unpaid wages of its employees, from one pocket and transfer the same money to another pocket, and to announce, in legal effect, that in this sum it was now indebted to the welfare association. It should have paid it to the association. It was guilty of conversion when it did not do so. The legal effect of such transaction was to make it a trustee ex maleficio. Bankrupt did not notify either party (employees or welfare association) of the transaction. It is true there was little or no difference in the two entities, the employees and the welfare association. But there was some—sufficient to make them separate entities. Only through accident, ill health or some other cause would an employee share in the benefits. For all practical, as well as legal consequences, therefore, the welfare association was an entity distinct from the employees whose wages created the fund out of which the welfare association paid its benefits.

Such a trust so cerated (a constructive trust, a trust ex maleficio) will not fall though other dollars may take the place of the original ones received when the employees made their contribution to the fund. "Dollars are fungibles and any one of them will be accepted as a substitute for another." Jennings v. U. S. F. & G. Co., 294 U. S. 216, 224.

The record shows there were at all times sufficient moneys in the bank deposits of the bankrupt to pay the amount due the welfare association.

It seems we have a case where A, the employees of B, consented to B's taking a certain amount each week from their wages and turning it over to a charitable organization, C, for the purpose of creating a fund to be managed and distributed by C among its ailing members. B deducted the money which A agreed might be deducted. After deduction, however, instead of B's delivering the money to C, B kept the money.

A somewhat similar situation is discussed in Adams v. Champion, 294 U. S. 231, 238, where it is said:

"* * * By a process of analysis a unitary transaction, the cancellation of a debt to a depositor, is treated as if split up into two parts, a fictitious withdrawal by the depositor

of coin or other currency, and its return to the bank to be applied upon the purchase. The money so returned is then [fol. 45] subjected to a trust and though mingled with other money is viewed as retaining its identity so long as any portion of the fund is discovered to be intact. *These fictions and presumptions may serve well enough in their application to one whose act is against equity and conscience at the time of its commission.* They may be implements of justice in cases of theft or actual fraud. So, at least, we now assume."

In the instant case, however, unlike that discussed in Adams v. Champion, supra, or in Jennings v. U. S. F. & G. Co., supra, there was not even the "unitary transaction." We do not have two parties dealing with one another—a depositor and a bank—out of whose transactions an implied relationship is assumed, but we have employees and an employer dealing with each other, the former creating a fund for the benefit of C, a third party. The employer's indebtedness to the employees was satisfied only upon employer's delivering the money to the third party, C. In carrying out this transaction employer credited itself, as against the employees, with having made the payment to C. As a matter of fact it did not make the payment to C, but converted the money to its own use. Under these circumstances we see no escape from the conclusion that a constructive trust, a trust ex maleficio, was created. The employer was a wrongdoer, a converter, from the moment it credited itself in full for payment of the employees' wages.

Some of the decisions upon which appellee relies must be distinguished on the ground that the party sought to be held as trustee was a national bank. Now, it is apparent that between a depositor and a bank, a well-nigh universal experience has resulted in the recognition of the status of the depositor and the relationship that exists between depositor and the bank. It is that of debtor and creditor. National bank statutes and the regulations of the National Banking Department governing the liquidation of insolvent banks are confirmatory of this relationship. Jennings v. U. S. F. & G. Co., supra; Adams v. Champion, supra; Old Company's Lehigh, Inc. v. Meeker, Receiver, et al., 294 U. S. 227.

A depositor who draws a check in favor of a bank with instructions to buy a security understands the position he

occupies. It is that of a creditor until the security is possessed by the bank. If a different status is desired, special instructions and deposits are necessary. Jennings v. U. S. [fol. 46] F. & G. Co., supra; Adams v. Champion, supra. If a depositor gives the bank a check against his account, with which to buy a bond, it is well understood that the debtor-creditor relationship extends as to this, as well as to the deposit transactions. Custom has given character to the transaction.

In the case of an employee who is seeking, or who has been compelled by his employer, to create a fund out of which sickness benefits may be paid to ailing employees, quite a different understanding arises. Unlike the bank depositor's situation, the employee has nothing to do with the withholding of his wages or its payment to the beneficiary company. He does not know of its payment or of its conversion, if any there be. He relies on his employer. He knows that his employer has the authority to withhold part of his wages and that he has done so. He also knows that the deduction of part of his wages is permissible only if the employer turns the same over to the welfare association. He does not know whether this has been done. There is no understanding—no implied agreement that the employer may hold the money indefinitely or otherwise and become a debtor of the welfare association. A contrary understanding exists, namely, that the employer must turn the money over to the welfare association immediately upon its deduction from the employee's wages. Failure to do so makes it a wrongdoer. Against such a wrongdoer and to protect the contributor, equity fastens a trust upon the transgressor and holds him as a trustee ex maleficio.

Such a trust, equity will follow even though there has been a commingling of the trust fund with private accounts. Jennings v. U. S. F. & G. Co., 294 U. S. 216, 226; Knatchbull v. Hallett, 13 Ch. Div. 696; Gorman v. Littlefield, 229 U. S. 19; Standard Oil Co. v. Hawkins, 74 F. 395.

It cannot be doubted, it is true, but that the wrongful action of the bankrupt might have been ratified by the welfare association. The latter's right against the bankrupt for conversion might have been waived and the bankrupt's action might have been ratified. In such case the relation of debtor and creditor and not that of trustee and cestui que trust would have arisen. We find nothing in the record

before us however that would support a finding that the bankrupt's retention of the money was agreed to or acquiesced in by the welfare association. A contrary deduction is unavoidable. The articles of the welfare association called for the investment of all of its funds in Government bonds. This negatived any possibility that the same might [fol. 47] be loaned to employer. It also appears that the welfare association demanded payment of the sum due it. Neither the employees nor the welfare association knew the facts. The employees did not know whether the money had been turned over to the welfare association or not. The welfare association did not know how much had been deducted from the employees' wages. It is elementary that no waiver of rights or ratification of wrongful actions can occur without knowledge of the facts.

Another approach to these facts and another syllogism lead to the same conclusion.

From acts and words, as well as from express agreement, the status of trustee may be created. Bogert on Trusts, Volume I, Section 45, page 197, states the rule as follows:

"The relationship of the parties, followed by acts affecting title and possession, may lead a court to imply a trust intent as actually existing and as having been expressed, although no words referring to a trust or trustee have been spoken or reduced to writing. In the creation of trusts settlors have never been handicapped by formalism. They have not been required to express their intention to create a trust in set phrases or words. * * *"

In the instant case the parties did not use the words "trust," "trustee," and "cestui que trust," but they dealt with one another in such a way, with respect to moneys which the employer held for the employees and later for the welfare association as to point directly to the existence of an implied trust. That is to say, the parties understood that the employer was to pay the twenty-five cents per month deducted from the employees' wages to the welfare association. Until the payment was made, however, it was to hold the money in trust for such welfare association. The obligation of the trustee terminated when payment was made.

This conclusion seems to be an irresistible one resulting from the consideration of the agreed facts and acts and the

necessary inferences which arose therefrom. The intention of the parties governs. Agreements informally reached, the details of which are frequently established by action, at times leaves the question of intent somewhat in doubt. At other times the object of the transaction and the acts of the parties speak even more persuasively than oral testimony and almost as effectively as formal but unintelligently prepared written agreements. Considering the purpose of [fol. 48] this agreement and all of the surrounding circumstances, it seems to us that the parties intended the wages withheld by the employer should be held by it as trustee until payment was made to the welfare association.

The decree is reversed with directions to enter one in accordance with the views here expressed.

[File endorsement omitted.]

In United States Circuit Court of Appeals

In the Matter of Grigsby-Grunow, Inc., Bankrupt

5498

Maurice Paradise, as Trustee,

vs.

Frank M. McKey, Trustee in Bankruptcy

Appeal from the District Court of the United States for the Northern District of Illinois, Eastern Division

Decree—December 7, 1935

This cause came on to be heard on the transcript of the record from the District Court of the United States for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On Consideration Whereof: It is now here ordered, adjudged and decreed by this court that the Order or Decree of the said District Court in this cause appealed from be, and the same is hereby reversed with costs, and that this cause be, and the same is hereby remanded to the said Dis-

trict Court with directions to enter a decree in accordance with the views expressed in the opinion of this court.

[fols. 49 & 50] In United States Circuit Court of Appeals

In the Matter of Grigsby-Grunow, Inc., Bankrupt

5499

Maurice Paradise, as Trustee,

vs.

Frank M. McKey, Trustee in Bankruptcy

Appeal from the District Court of the United States for the Northern District of Illinois, Eastern Division

Decree—December 7, 1935

This cause came on to be heard on the transcript of the record from the District Court of the United States for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On Consideration Whereof: It is now here ordered, adjudged and decreed by this court that the Order or Decree of the said District Court in this cause appealed from be, and the same is hereby reversed with costs; and that this cause be, and the same is hereby remanded to the said District Court with directions to enter a decree in accordance with the views expressed in the opinion of this court.

[fol. 51] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 52] Supreme Court of the United States, October Term, 1935

No. 785

Order Allowing Certiorari—Filed April 6, 1936

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit is

granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[fol. 53] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1935

No. 786

ORDER ALLOWING CERTIORARI—Filed April 6, 1936

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Endorsed on cover: File Nos. 40,339, 40, 340. U. S. Circuit Court of Appeals, Seventh Circuit. Term No. 785. Frank M. McKey, Trustee in Bankruptcy, petitioner vs. Maurice Paradise, as Trustee. Term No. 786. Frank M. McKey, Trustee in Bankruptcy, petitioner, vs. Maurice Paradise, as Trustee. Petition for writs of certiorari and exhibit thereto. Filed March 4, 1936. Term Nos. 785, O. T., 1935, 786, O. T., 1935.

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CHARLES ...

IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1935.

No. [redacted] 4 [redacted] 5

IN THE MATTER OF GRIGSBY-GRUNOW COMPANY,
BANKRUPT.

FRANK M. McKEY, TRUSTEE IN BANKRUPTCY,
Petitioner,

vs.

MAURICE PARADISE, AS TRUSTEE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

WILLIAM E. LEAHY,
WILLIAM J. HUGHES, JR.,
of Washington, D. C.,
Counsel for Petitioner.

A. L. SCHAPIRO,
B. C. SCHIFF,
of Chicago, Illinois,
Of Counsel.

THE GUNTHORP-WARREN PRINTING COMPANY, 310 WEST JACKSON, CHICAGO

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IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1935.

No.....

IN THE MATTER OF GRIGSBY-GRUNOW COMPANY, BANKRUPT.

FRANK M. McKEY, TRUSTEE IN BANKRUPTCY,
Petitioner,

vs.

MAURICE PARADISE, AS TRUSTEE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioner, Frank M. McKey, as Trustee in Bankruptcy of the Grigsby-Grunow Company respectfully prays that a writ of certiorari issue to the Circuit Court of Appeals for the Seventh Circuit to review decrees of that court entered December 7, 1935 reversing a decree of the United States District Court for the Northern District of Illinois, Eastern Division. A certified transcript of the record in the case, including the proceedings in said Circuit Court of Appeals is furnished herewith in accordance with Rule 38, Paragraph 1 of the rules of this Court.

Statement of Matters Involved.

The Grigsby-Grunow Company was adjudicated a bankrupt on March 13, 1934 and Frank M. McKey, the petitioner herein was duly elected and qualified as trustee in bankruptcy on April 16, 1934, and the bankruptcy estate is now under liquidation.

On June 29, 1934 Maurice Paradise, as Trustee for approximately three thousand former employees of the Grigsby-Grunow Company, the respondent herein, filed in said bankruptcy proceeding a certain petition designated "Petition for Allowance of Preferred Claims" (R. 2-6) to which petition an answer was filed by Frank M. McKey, Trustee in Bankruptcy on July 27, 1934 (R. 7-11) which in substance denied that said claim was entitled to priority of payment within any of the provisions of the Bankruptcy Act.

On October 16, 1934 a stipulation of facts was entered into between the parties (R. 12-15) and filed in said bankruptcy proceeding.

Thereafter hearings were had before the Referee in Bankruptcy to whom the bankruptcy estate was generally referred and on December 14, 1934 said Referee entered an order allowing the said petition of Maurice Paradise, as Trustee and directing your petitioner to pay the said Maurice Paradise, as Trustee the sum of Fourteen Thousand Six Hundred Seven Dollars and Fifty-one Cents ($14,607.51) (R. 16-17).

A petition for review was filed with said Referee in Bankruptcy who certified the proceedings to the District Court, the Honorable John P. Barnes, District Judge presiding (R. 18-19) and thereafter proceedings were had before said District Judge on said petition for review which resulted in an order being entered on March 28, 1935 re-

versing the order of the Referee and allowing the petition of Maurice Paradise, as Trustee, to stand as a general claim against the bankruptcy estate (R. 20-21) from which order two appeals were taken to the Circuit Court of Appeals for the Seventh Circuit, one as a matter of right, and the other with the consent of said Circuit Court of Appeals, which two appeals were later consolidated in said Circuit Court of Appeals by order of said Court (R. 27-28).

Thereafter on December 7, 1935 decrees were entered in said Circuit Court of Appeals reversing the decree of the District Court with directions to enter one in accordance with the views expressed in the opinion of said court (R. 40-49), the effect of which, if permitted to stand, would be to allow to Maurice Paradise, as Trustee, a prior claim in the sum of Fourteen Thousand Six Hundred Seven Dollars and Fifty-one Cents ($14,607.51).

While the facts have been stipulated to and appear at length in the record (R. 12-15) the following is a brief resume of the facts leading up to the controversy herein.

On February 4, 1933 and prior thereto, the Grigsby-Grunow Company maintained in connection with its business an unincorporated organization known as the "Majestic Employees' Welfare Association", which had been formerly known as the "Majestic Welfare and Athletic League". The Association's purpose was to provide life, health and accident insurance for the benefit of the employees of the bankrupt and their dependents. The Association was governed by its own officers and directorate and maintained its own account in The First National Bank of Chicago. The funds of the Association were invested exclusively in obligations of the United States Government, and the earnings and increment of these investments were used for the insurance benefits contemplated by the Association's constitution and by-laws.

The membership of the Association was comprised exclusively of employees who had been employed for thirty (30) days or more and who had paid the initial fee of One Dollar ($1.00) to the treasury of the Association. The initial fee was automatically deducted by the Grigsby-Grunow Company from the amount due as salary or wages of each employee employed for the required period. In addition to the initial fee there were weekly dues of Twenty-five Cents ($.25) per week which were likewise automatically deducted by the Grigsby-Grunow Company from the amount due each member as salary or wages.

Prior to February 4, 1933 the Grigsby-Grunow Company regularly paid the Association by check, which was deposited in the Association's treasury, the accumulations of each payroll deduction, less deductions for expenses of the Association paid by the Grigsby-Grunow Company.

Commencing with February 4, 1933, however, the Grigsby-Grunow Company began to fall in arrears and from that time until November 24, 1933 when receivers in equity were appointed for the Grigsby-Grunow Company (who were later superceded by the receiver and trustee in bankruptcy) there was always a balance to the credit of the Association, which the Grigsby-Grunow Company had not paid to the Association. On November 24, 1933 said balance was in the sum of Fourteen Thousand Six Hundred Seven Dollars and Fifty-one Cents ($14,607.51).

The deductions of Twenty-five Cents ($.25) per week, including deduction for the initial fee, were made by charging the employees' account on the payroll records of the Grigsby-Grunow Company and crediting the aggregate of all such deductions to the account of the Majestic Employees' Welfare Association on the books of the Grigsby-Grunow Company.

No actual money was taken from the payroll envelopes

of the employees and deposited in any account of the Grigsby-Grunow Company, but to the contrary the matter was handled as a mere bookkeeping entry, and at no time did the Grigsby-Grunow Company segregate any money due the Majestic Employees' Welfare Association or deposit any money in any separate trust account or bank account.

On November 24, 1933 the aggregate balances in all bank accounts of the bankrupt exceeded the amount claimed and at all times from February 4, 1933 to November 24, 1933 the total of daily balances of all the accounts exceeded the amount claimed. However, the general account of the bankrupt had during the period been reduced by withdrawals to a low point on September 23, 1933 to Four Thousand Three Hundred Five Dollars and Thirty Cents ($4,305.30) (R. 15).

On or about August 12, 1933 the Majestic Employees' Welfare Association was formally dissolved and disbanded and its assets were taken over by the Majestic Works Council, which like the Association, was an unincorporated organization in which the bankrupt and its employees had equal representation.

After the equity receivers had been appointed, but before these bankruptcy proceedings were instituted the Majestic Works Council disbanded, but before disbanding authorized Maurice Paradise to act as trustee for the employees to collect the amount alleged to be owing from the Grigsby-Grunow Company, and it was in this capacity that the claim was filed in these proceedings.

It was further stipulated that no part of the Fourteen Thousand Six Hundred Seven Dollars and Fifty-one Cents ($14,607.51) claimed represented wages earned within three months before the date of the commencement of court proceedings (R. 39).

REASONS FOR GRANTING THE WRIT.

I.

The decision of the court below in this case has decided a federal question in a way probably in conflict with applicable decisions of this Court.

II.

The court below has decided an important question of general law in a way probably untenable or in conflict with the weight of authority.

III.

The court below has decided an important question of local law in conflict with the decisions of the Supreme Court of Illinois in *Bayor* v. *American Trust & Savings Bank*, 157 Ill. 62, and *Colegrove & Co. Bank* v. *Gaupp*, 357 Ill. 499.

IV.

The court below has rendered a decision in probable conflict with the decisions of the Circuit Court for the Eighth Circuit in the cases of *Southern Bell Telephone & Telegraph Company* v. *R. B. Caldwell*, 67 F. 2d 802, and *Burton Coal Co.* v. *Franklin Coal Co.*, 67 F. 2d 796.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this court directed to the United States Circuit Court of Appeals for the Seventh Judicial Circuit, sitting at Chicago, Illinois, commanding said court to send to this court on a day to be designated, a full and complete transcript of the record and all proceedings of the Circuit Court of Appeals

had in this cause, to the end that this cause may be reviewed and determined by this Court; that the orders of the Circuit Court of Appeals for the Seventh Judicial Circuit reversing the decree of the District Court be reversed and remanded; and that the petitioner be granted such other and further relief as may seem proper.

WILLIAM E. LEAHY,
WILLIAM J. HUGHES, JR.,
Counsel for Petitioner.

A. L. SCHAPIRO,
B. C. SCHIFF,
Of Counsel.

BRIEF IN SUPPORT OF PETITION.

I.

OPINIONS BELOW.

The opinion of the District Court has not been officially reported but is printed in full in the record (R. 20).

The opinion of the Circuit Court of Appeals is reported in 80 F. 2d 478 (R. 40).

II.

JURISDICTION.

The jurisdiction of this court is invoked under Section 240-A of the judicial code as amended by the act of February 13, 1925. (28 U. S. C. A. Sec. 347-A).

The date of the decrees of the Circuit Court of Appeals for the Seventh Circuit (R. 48-49) sought to be reviewed was December 7, 1935.

III.

STATEMENT OF THE CASE.

The facts have been fully set forth under the caption "Statement of Matters Involved" which is hereby adopted.

IV.

SPECIFICATIONS OF ERROR.

The Circuit Court of Appeals erred—

a. In holding that a trust relationship existed between the Grigsby-Grunow Company and the Majestic Employees Welfare Association, or the successors of said Majestic Employees Welfare Association.

b. In holding that a mere "indebtedness or liability to account" could be the subject of conversion.

c. In holding that the creation of an "indebtedness or liability to account" by mere bookkeeping entries such as the debiting of one set of accounts and the crediting of another account on the books of the bankrupt, could be the subject of a trust or establish a trust fund which could be traced or identified.

d. In holding that the claim of Maurice Paradise, as Trustee was entitled to priority of payment.

e. In not following the federal rule of "augmentation of assets" as applied to estates of insolvents.

f. In reversing the decree of the District Court.

SUMMARY OF ARGUMENT.

I.

The relationship of debtor and creditor between employer and employee existing at the inception of the transactions in question persisted throughout, notwithstanding the failure of the bankrupt company to carry out its promise to pay to the welfare association a sum equivalent to amounts charged against the employees.

II.

A transfer of funds by mere bookkeeping entries, such as the debiting of a number of accounts and the crediting of other accounts without segregation of some specific or identifiable property, does not create a fund which can be traced or which can be said to augment the assets of an estate coming into the hands of a trustee in bankruptcy.

III.

In bankruptcy proceedings if a claim for priority of payment does not come within the provisions of Section 64 (b) of the Bankruptcy Act, the claimant is not entitled to a prior claim unless he can establish that property belonging to him came into the estate and is traceable into the hands of the trustee in its original or substituted form.

ARGUMENT.

I.

THE DECISION OF THE COURT BELOW IN THIS CASE HAS DECIDED A FEDERAL QUESTION IN A WAY PROBABLY IN CONFLICT WITH APPLICABLE DECISIONS OF THIS COURT.

The Circuit Court of Appeals in this case appear to have predicated their decision on the theory (a) that the bankrupt was guilty of a conversion of property of its employees and, therefore, stood in the position of a trustee *ex maleficio*, and proceed to allow priority to the claimant because (b) "the record shows that there were at all times sufficient moneys in the bank deposits of the bankrupt to pay the amount due the welfare association" (R. 44). This decision is in direct conflict with the decision of this court in *St. Louis & S. F. R. Co.* v. *Spiller*, 274 U. S. 304-309; 71 L. E. 1060-67.

In *St. Louis & S. F. R. Co.* v. *Spiller*, 274 U. S. 304-309, 71 L. E. 1060-67, a railroad company had exacted illegal freight rates, which it was subsequently ordered to repay to the shipper. The Court of Appeals held that the railroad company became liable as trustee *ex maleficio* for the overcharges and that this liability was enforceable as upon a constructive trust, the only claim made that the money collected could be traced into the receiver's hands was that throughout the ten years which elapsed between the earliest exaction and the transfer of properties to the new company, the old one and the receiver had at all times in the several banks on which checks for various expenses were drawn, a working balance in the aggregate largely in excess of the shipper's claim. This court in passing upon said contention, in its opinion, on pages 309 and 310, held as follows:

"The assertion that the money collected can be

traced into the receiver's hands is confessedly without any support except the stipulated fact that throughout the ten years which elapsed between the earliest exaction and the transfer of the properties to the new company, the old one and the receiver had at all times in the several banks on which checks for current expenses were drawn, a working balance in the aggregate largely in excess of Spiller's claim. Such a showing fails to bring the present case within the rule by which, when trust funds are mingled with others, the *cestui* may assert an equitable lien upon the mingled mass to the extent of his contribution thereto." (Citing cases.)

"An illegal exaction does not impress an indelible trust upon all funds which the wrongdoer and his successors may thereafter have on deposit in their banks. For aught that appears all the money illegally exacted may have been spent for current operating expenses."

The decision of the Circuit Court of Appeals in this case also treated the arrangement of bookkeeping whereby the bankrupt credited the account of the welfare association and debited the payroll accounts of the employees as creating a fund which could be the subject of a trust (R. 44). This theory is also in direct conflict with the holding of this court in *Blakely* v. *Brinson*, 286 U. S. 254-263, 76 L. E. 1089-92, where this court held as follows:

"The cancellation of the credit balance by the debit neither suggests any intention to establish a trust nor points to any identifiable thing which could be the subject of it."

II.

THE COURT BELOW HAS DECIDED AN IMPORTANT QUESTION OF GENERAL LAW IN A WAY PROBABLY UNTENABLE OR IN CONFLICT WITH THE WEIGHT OF AUTHORITY.

1. The Federal Courts have long followed the rule of "augmentation of assets" and have held that a transfer of funds by mere bookkeeping entries, without actual segregation, is not sufficient because it does not augment the assets of the estate and consists merely of a shifting of credits.

The stipulation of facts clearly shows that there never was a trust fund; that no money passed between the employees and the Grigsby-Grunow Company so that there was nothing that ever existed which could be commingled or be the subject of a conversion (R. 13).

In the case of *Mechanics' & Metals National Bank of City of New York* v. *Buchanan,* 12 F. 2d 891 (C. C. A. 8) a preferential claim against funds of the bank in the hands of a receiver was sought on a trust fund theory. In said case, as well as in the present instance, no payments in money were in fact made, the transactions being a mere bookkeeping transfer. Citing from page 892 the court held:

> "It is conceded that no payments in money were in fact made; therefore, the funds of the bank were not augmented in any way. The original notes were not taken up in whole or in part, but were left in the possession of appellant, which had no notice of the transaction prior to insolvency. A mere bookkeeping transfer was made which would have been effective perhaps if the bank had continued as a going concern, but by which the funds of the bank were in no respect augmented. It consisted merely of a shifting of credits on the books of the bank. The rule applicable is thus announced in *Beard* v. *Independent District of Pella City* (C. C. A. 8) 88 F. 375, 31 C. C. A. 562.
>
> It is indispensable to the maintenance by a *cestui que* trust of a claim to preferential payment by a receiver out of the proceeds of the estate of an insolvent that clear proof be made that the trust property or its proceeds went into a specific fund or into a specific identified piece of property which came to the hands of the receiver. The case made by appellant falls short of this requirement. Transactions upon which it relies consisted of a mere shifting of credits on the books of the insolvent bank. The assets of that bank were not increased thereby, nor were any funds set apart which, or any part of which, came into the hands of the receiver."

2. The better doctrine and that sustained by weight of authority, is that a trust fund can be followed and recovered

in bankruptcy only when it can be clearly traced and identified in some specific fund or property coming into the hands of a receiver or trustee in bankruptcy.

The law is well settled that even assuming a trust fund actually existed, before it can be followed and recovered in bankruptcy proceedings, it must be clearly traced and identified in some specific fund or property coming into the hands of the trustee in bankruptcy, and that the burden of proof in tracing said fund rests upon the claimant thereto.

These principles have been upheld in the following cases involving bankruptcy proceedings:

In the matter of J. Albert See, Bankrupt, 209 F. 172 (C. C. A. 2d).

In re McIntyre & Co., 185 F. 96 (C. C. A. 2d).

In re Newark Shoe Stores, Inc., 3 Fed. Sup. 293 D. C. Md.

These principles also find support in the decision of this court in *St. Louis & S. F. R. Co.* v. *Spiller,* 274 U. S. 304-309, 71 L. E. 1060-67, and in the case of *Harmer* v. *Rendelman,* 64 F. 2d. 422 (C. C. A. 4).

In the case of *Newark Shoe Stores, Inc.,* 3 Fed. Sup. 293, approximately three hundred (300) employees of the Newark Shoe Stores, Inc., a bankrupt, filed a prior claim in said bankruptcy proceedings, based upon deposits of Two Hundred Dollars ($200.00) which each of said employees had made with the bankrupt as security for the faithful performance of their duties and which amount was to be returned to them upon the termination of their employment. These deposits were collected over a period of fifteen years and were commingled with other deposits of the bankrupt. At no time were the aggregate balances of the combined bank accounts of the bankrupt less than approximately Sixty-eight Thousand Dollars ($68,000.00), more than enough to discharge the amount of all said deposit claims.

The employees contended that they were entitled to priority on either of two grounds—first, that the deposits were in the nature of trust funds to which the bankrupt company does not obtain any beneficial title, and—second, that the deposits were entitled to priority upon general equitable principles.

The court held that the deposits were in the nature of trust funds though not entitled to priority on so-called general equitable principles, but further held it would not necessarily follow that all or any of the deposits should be refunded. Quoting from the decision:

> "No deposit can be, unless at the present time, it is definitely traceable into one of the company's bank accounts, and only if it can be shown that such bank account has never been less than the amount of such deposit and that the funds in that account have come into the hands of the trustee in these bankruptcy proceedings." (Citing cases.)
>
> "The apparent hardship of the ruling herein announced is regrettable, but courts may not, without warrant, extend the clearly defined limitations of the Bankruptcy Act and create preferred creditors, in derogation of the rights of general creditors."

This decision was decided on authority of *St. Louis & S. F. R. Co.* v. *Spiller*, 274 U. S. 304-309, 71 L. E. 1060-67.

In the case of *Colegrove & Co. Bank* v. *Gaupp*, 357 Ill. 499, the Supreme Court of Illinois, in October, 1934, held as follows:

> "The right to reclaim a trust fund is founded on the right of the ownership of the fund on the part of the party claiming the same to have it restored to him by the party having possession of the fund. Such claim is not based upon the relationship of debtor and creditor or *tort feasor* but is bottomed solely on ownership. Therefore, to recover as a *cestui que* trust, the owner or beneficiary of the trust property must prove that the alleged trustee has, in fact, the property even though it be in an altered form. Failing in this the trust fails, and the claims, if there is any legal liability therefor

becomes merely one of compensation on the same plane as other general debts."

3. The decision of the court below in effect holds that where a constructive trust is created, that is a trust *ex maleficio*, all of the property of the trustee is charged with the claim of the *cestui que*. This theory is against the weight of authority, as will appear from an examination of *St. Louis & S. F. R. Co.* v. *Spiller*, 274 U. S. 304-309, 71 L. E. 1060-67, and the following cases:

In the case of *Spokane County* v. *First National Bank of Spokane*, 68 F. 979 (C. C. A. 9) the court held:

> "The owner of property entrusted to another, by whom it has been misapplied, is not entitled to a general lien upon the assets of the trustee for the value of such property, but can only follow the same so far as it can be traced, either in its original form or in other forms into which it has been converted."

In the case of *Burgoyne* v. *McKillip*, 182 F. 452-454 (C. C. A. 8) (Cert. denied 55 L. E. 605) the court held as follows:

> "Although a demand may be founded on a breach of trust, the entire estate of the recreant trustee is not thereby necessarily impressed with a trust."

In the case of *Samuel Little and others* v. *Joseph H. Chadwick and others*, 151 Mass. 109, the court held:

> "When trust money becomes so mixed up with the trustee's individual funds that it is impossible to trace and identify it as entering into some specific property, the trust ceases. The court will go as far as it can in thus tracing and following the trust money but when as a matter of fact it cannot be traced, the equitable right of the *cestui que* trust to follow it fails. Under said circumstances, if the trustee has become bankrupt, the court cannot say that the trust money is to be found somewhere in the general estate of the trustee and still remains. He may have lost it with property of his own and in such case the *cestui que* can only come in and share with the general creditors."

In the case of *Worchester Bank & Trust Co., Trustee* v. *Robert A. Nordblom,* 285 Mass. 22-25, the court held as follows:

> "Apart from statute, in the distribution of the assets of an insolvent or deceased trustee, a claim based on the duty of the trustee or its breach is entitled to no priority because of its origin. Inherently a claim upon a grocery bill or promissory note ranks as high. It is only where some of the assets can be shown to be a part of the trust estate, or the product of the conversion of specific funds, or property of the trust estate into another form, that the trust estate can obtain an advantage over the creditors generally. That advantage is not a right to priority or preference but rather a right to reclaim assets of the trust estate that can be traced and found."

It would, therefore, appear from the cases cited that the court below has decided three important questions of general law in an untenable manner, in conflict with the weight of authority, which should be corrected by this Honorable Court.

III.

THE COURT BELOW HAS DECIDED AN IMPORTANT QUESTION OF LOCAL LAW IN CONFLICT WITH THE DECISIONS OF THE SUPREME COURT OF ILLINOIS IN BAYOR V. AMERICAN TRUST & SAVINGS BANK, 157 ILL. 62, AND COLEGROVE & CO. BANK V. GAUPP, 357 ILL. 499.

In holding that a constructive trust was created by the transactions between the Grigsby-Grunow Company and its employees the decision of the court below is in conflict with the decisions of the Supreme Court of Illinois.

In the case of *Susan M. Bayor* v. *American Trust & Savings Bank, Assignee,* 157 Ill. 62-68, the Supreme Court of Illinois held as follows:

> "Where the relation between the parties is primarily that of a debtor and creditor and there is a mere unperformed agreement on the part of the debtor to

create a specific fund which shall possess a separate identity, and to hold the same in trust, it would be illogical and inconsistant with these adjudications to hold that such a creditor occupies a stronger position than one who is primarily the beneficiary of a distinct and identified trust fund." (The trust fund referred to is one made by the assignment by the debtor of its assets to the American Trust & Savings Bank for the benefit of its creditors.)

In the case of *Colegrove & Co. Bank* v. *Gaupp*, 357 Ill. 499, the Supreme Court of Illinois held that to create a trust, there must be a *res* in existence upon which the trust can act, and the mere execution and delivery of a declaration of trust is not sufficient to create a trust if, in fact, no *res* exists upon which it may operate.

IV.

THE COURT BELOW HAS RENDERED A DECISION IN PROBABLE CONFLICT WITH THE DECISIONS OF THE CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT IN CASES OF SOUTHERN BELL TELEPHONE & TELEGRAPH COMPANY V. R. B. CALDWELL, 67 F. 2D 802 (C. C. A. 8) AND BURTON COAL CO. V. FRANKLIN COAL CO. 67 F. 2D 796 (C. C. A. 8).

The effect of the decision of the court below is to allow a claim in a bankruptcy proceeding which clearly did not come within the classification of claims entitled to priority as established by Section 64 (b) of the Bankruptcy Act as amended. The claim also could not be sustained upon the theory of reclamation of property belonging to the claimant. Therefore, the decision must be said to rest upon general principles of equity jurisprudence.

In the case of *Burton Coal Co.* v. *Franklin Coal Co.* 67 F. 2d 796 (C. C. A. 8) the court held as follows (page 797):

"Some question is raised as to the equity jurisdiction of the Bankruptcy Court. That it is a court of

equity in the sense that its judges and referees in adjudging the rights of parties entitled to their decision are governed by principles and rules of equity jurisprudence, is beyond question. (Citing Cases.)

"It has not, however, plenary jurisdiction in equity but is confined in the application of the rules and principles of equity to the jurisdiction conferred upon it by the provisions of the Bankruptcy Act reasonably interpreted." (Citing Cases.)

"The plain mandate of the law cannot be set aside because of considerations which may appeal to the Referee or Judge as falling within general principles of equity jurisprudence."

In the case of *Southern Bell Telephone & Telegraph Company* v. *R. B. Caldwell*, 67 F. 2d 802 (C. C. A. 8) the claimant sought priority of payment on equitable grounds. The Referee in passing on the question held that Section 64 (b) is exclusive as to classes of debts which are entitled to priority of payment in advance of payment of dividends to creditors and that the petitioner's claim did not fall within any of the classes as set forth in said section. The Court of Appeals in said case sustained the contention of the Referee, citing with approval its former decision in *Burton Coal Co.* v. *Franklin Coal Co.* 67 F. 2d 796 (C. C. A. 8).

It is submitted that a conflict exists between the Seventh Circuit and the Eighth Circuit on this question which should be corrected by this Honorable Court.

Conclusion.

It is, therefore, respectfully submitted that this case calls for the exercise by this court of its supervisory powers to the end that the decision of the Circuit Court of Appeals, which is herein contended to be in conflict with applicable decisions of this court, and which has decided important questions of local and general law in a way

probably untenable or in conflict with the weight of authority of both the Federal and the State Courts, and which has decided an important bankruptcy question in a way so as to be contrary to the express provisions and intent of the Bankruptcy Act may be reviewed; and that to such an end a writ of certiorari be granted and this court review and reverse said decision of the Circuit Court of Appeals for the Seventh Circuit.

Respectfully Submitted,

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IN THE

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OCTOBER TERM, 1936.

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v.

MAURICE PARADISE, As Trustee, *Respondent*.

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FRANK M. McKEY, Trustee in Bankruptcy, *Petitioner*,

v.

MAURICE PARADISE, As Trustee, *Respondent*.

On Writs of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.

BRIEF FOR PETITIONER.

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On Writs of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.

BRIEF FOR PETITIONER FRANK M. McKEY, TRUSTEE IN BANKRUPTCY.

OPINIONS BELOW.

The opinion of the District Court has not been officially reported but is printed in full in the record (R. 17).

The opinion of the Circuit Court of Appeals (R. 29-37) is reported in 80 F. 2d 478.

JURISDICTION.

The date of the decree of the Circuit Court of Appeals for the Seventh Circuit (R. 37-38) sought to be reviewed was December 7, 1935.

The petition for writs of certiorari was filed March 4, 1936 and was granted April 6, 1936.

The jurisdiction of this court is invoked under Section 240 (a) of the Judicial Code as amended by the act of February 13, 1925. (28 U. S. C. A. Sec. 347 (a).)

STATUTES INVOLVED.

Bankruptcy Act, Section 64 (b), (11 U. S. C. A., Sec. 104):

> Sec. 104. *Debts Which Have Priority.* (b) The debts to have priority, except as herein provided, and to be paid in full out of bankrupt estates, and the order of payment shall be * * * (5) Wages due to workmen, clerks, traveling or city salesmen, or servants, which have been earned within three months before the date of the commencement of the proceedings, not to exceed $600.00 to each claimant.

Section 17 (11 U. S. C. A., Sec. 35):

> Sec. 35. *Debts Not Affected By a Discharge.* A discharge in bankruptcy shall release a bankrupt from all of his provable debts, except such as * * * (5) are for wages due to workmen, clerks, traveling or city salesmen, or servants, which have been earned within three months before the date of the commencement of the proceedings in bankruptcy; or (6) are due for moneys of an employee received or retained by his employer to secure the faithful performance by such employee of the terms of a contract of employment.

Section 47 (11 U. S. C. A., Sec. 75):

> Sec. 75. *Duties of Trustees.* (a) Trustees shall respectively * * * (2) collect and reduce to money the property of estates for which they are trustees under the direction of the court, and close up the estate as expeditiously as is compatible with the best

interests of the parties in interest; and such trustees as to all property in the custody or coming into the custody of the bankruptcy court, shall be deemed vested with all of the rights, remedies and powers of a creditor holding a lien by legal or equitable proceeding thereon; * * *

STATEMENT.

The Grigsby-Grunow Company was adjudicated a bankrupt on March 13, 1934 and Frank M. McKey, the petitioner herein, was duly elected and qualified as trustee in bankruptcy on April 16, 1934, and the bankruptcy estate is now under liquidation.

On June 29, 1934 Maurice Paradise, as Trustee for approximately three thousand former employees of the Grigsby-Grunow Company, the respondent herein, filed in said bankruptcy proceeding a certain petition designated "Petition for Allowance of Preferred Claims" (R. 1-5) to which petition an answer was filed by Frank M. McKey, Trustee in Bankruptcy on July 27, 1934 (R. 6-10) which in substance denied that said claim was entitled to priority of payment within any of the provisions of the Bankruptcy Act.

On October 16, 1934 a stipulation of facts was entered into between the parties (R. 10-14) and filed in said bankruptcy proceeding.

Thereafter hearings were had before the Referee in Bankruptcy to whom the bankruptcy estate was generally referred and on December 14, 1934 said Referee entered an order allowing the said petition of Maurice Paradise, as Trustee and directing your petitioner to pay the said Maurice Paradise, as Trustee, the sum of $14,607.51 (R. 14-15).

A petition for review was filed with said Referee in Bankruptcy who certified the proceedings to the District Court, the Honorable John P. Barnes, District Judge presiding (R. 15-17) and thereafter proceedings were had

before said District Judge on said petition for review which resulted in an order being entered on March 28, 1935 reversing the order of the Referee and allowing the petition of Maurice Paradise, as Trustee, to stand as a general claim against the bankruptcy estate (R. 17-18) from which order two appeals were taken to the Circuit Court of Appeals for the Seventh Circuit, one as a matter of right, and the other with the consent of said Circuit Court of Appeals, which two appeals were later consolidated in said Circuit Court of Appeals by order of said Court (R. 27).

Thereafter on December 7, 1935 decrees were entered in said Circuit Court of Appeals reversing the decree of the District Court with directions to enter one in accordance with the views expressed in the opinion of said court (R. 37-38), the effect of which, if permitted to stand, would be to allow to Maurice Paradise, as Trustee, a prior claim in the sum of $14,607.51.

On April 6, 1936, this court granted the petition of Frank M. McKey, as trustee in bankruptcy for certiorari. (R. 38-39.)

While the facts have been stipulated to and appear at length in the record (R. 10-14) the following is a brief resume of the facts leading up to the controversy herein.

On February 4, 1933 and prior thereto, the Grigsby-Grunow Company maintained in connection with its business an unincorporated organization known as the "Majestic Employees' Welfare Association" which had been formerly known as the "Majestic Welfare and Athletic League". The Association's purpose was to provide life, health and accident insurance for the benefit of the employees of the bankrupt and their dependents. The Association was governed by its own officers and directorate and maintained its own account in The First National Bank of Chicago. The funds of the Association were invested exclusively in obligations of the United States Government and the earnings and increment of these invest-

ments were used for the insurance benefits contemplated by the Association's constitution and by-laws. The membership of the Association was comprised exclusively of employees who had been employed for thirty days or more and who had paid the initial fee of $1.00 to the treasury of the Association. The initial fee was automatically deducted by the Grigsby-Grunow Company from the amount due as salary or wages of each employee employed for the required period. In addition to the initial fee there were weekly dues of twenty-five cents per week which were likewise automatically deducted by the Grigsby-Grunow Company from the amount due each member as salary or wages. (R. 10-11)

Prior to February 4, 1933 the Grigsby-Grunow Company regularly paid the Association by check an amount equivalent to the accumulations of each payroll deduction, less deductions for expenses of the Association paid by the Grigsby-Grunow Company, which was deposited in the Association's treasury, and which check was charged to the Association's account on the books of the Grigsby-Grunow Company. (R. 11)

Commencing with February 4, 1933, however, the Grigsby-Grunow Company began to fall in arrears and from that time until November 24, 1933 when receivers in equity were appointed for the Grigsby-Grunow Company (who were later superseded by the receiver and trustee in bankruptcy) there was always a balance to the credit of the Association, which the Grigsby-Grunow Company had not paid to the Association. On November 24, 1933 said balance was in the sum of $14,607.51. (R. 11)

The deductions of twenty-five cents per week, including deduction for the initial fee, were made by charging the employees' account on the payroll records of the Grigsby-Grunow Company and crediting the aggregate of all such deductions to the account of the Majestic Employees' Welfare Association on the books of the Grigsby-Grunow Company. (R. 11)

No actual money was taken from the payroll envelopes of the employees and deposited in any account of the Grigsby-Grunow Company, but to the contrary the matter was handled as a mere bookkeeping entry, and at no time did the Grigsby-Grunow Company segregate any money due the Majestic Employees' Welfare Association or deposit any money in any separate trust account or bank account. (R. 11)

On November 24, 1933 the aggregate balances in all bank accounts of the bankrupt exceeded the amount claimed and at all times from February 4, 1933 to November 24, 1933 the total of daily balances of all the accounts exceeded the amount claimed. However, the general account of the bankrupt had during the period been reduced by withdrawals to a low point on September 23, 1933 to $4305.30 (R. 14).

On or about August 12, 1933 the Majestic Employees' Welfare Association was formally dissolved and disbanded and its assets were taken over by the Majestic Works Council, which like the Association, was an unincorporated organization in which the bankrupt and its employees had equal representation. (R. 11)

After the equity receivers had been appointed, but before these bankruptcy proceedings were instituted the Majestic Works Council disbanded, but before disbanding authorized Maurice Paradise to act as trustee for the employees to collect the amount alleged to be owing from the Grigsby-Grunow Company, and it was in this capacity that the claim was filed in these proceedings. (R. 12)

It was further stipulated that no part of the $14,607.51 claimed represented wages earned within three months before the date of the commencement of court proceedings (R. 28).

SPECIFICATION OF ERRORS TO BE URGED.

The Circuit Court of Appeals erred:

1. In holding that a trust relationship existed between the Grigsby-Grunow Company and the Majestic Employees' Welfare Association, or the successors of said Majestic Employees' Welfare Association.

2. In holding that the creation of an "indebtedness or liability to account" by mere bookkeeping entries such as the debiting of one set of accounts and the crediting of another account on the books of the bankrupt could be the subject of a trust or establish a trust fund which could be traced or identified.

3. In not following the federal rule of augmentation of assets as applied to estates of insolvents.

4. In holding that a mere "indebtedness or liability to account" could be the subject of conversion.

5. In holding in effect that where a constructive trust is created, i.e. a trust ex maleficio, that all of the property of the trust ex maleficio is charged with the claim of the cestui que trust.

6. In holding that the claim of Maurice Paradise, as Trustee was entitled to priority of payment.

7. In reversing the decree of the District Court.

SUMMARY OF ARGUMENT.

I.

The relationship of debtor and creditor between employer and employee, existing at the inception of the transactions in question, persisted throughout, notwithstanding the failure of the bankrupt company to carry out its promise to pay to the Welfare Association a sum equivalent to amounts charged against the employees, less deductions for the expenses of the Association paid by the bankrupt company.

II.

A transfer of accounts by mere bookkeeping entries, such as the debiting of a number of accounts and the crediting of another account without segregation of some specific or identifiable property does not create a fund which can be traced, or which can be said to augment the assets of an estate coming into the hands of a trustee in bankruptcy.

III.

The federal rule of augmentation of assets as applied to estates of insolvents should be extended to estates being liquidated under federal bankruptcy proceedings, since the theory of said type of proceedings is to secure an equal distribution of assets among all the creditors of the insolvent and to prevent preferences.

IV.

A mere "indebtedness or liability to account" cannot be the subject of trover or conversion since only tangible property can be the subject of conversion.

V.

The property coming into the hands of the trustee in bankruptcy is not charged with a general lien in favor of the claimant even though the bankrupt might be held to have been a trustee ex maleficio.

VI.

In bankruptcy proceedings, if a claim for priority of payment does not come within the provisions of Section 64B of the Bankruptcy Act, the claimant is not entitled to a prior claim unless he can establish that property belonging to him came into the estate and is traceable in the hands of the trustee in its original or substituted form.

VII.

Where the findings of a Referee are a deduction from established facts, or uncontradicted evidence, the Judge is at liberty to draw his own inferences and deduce his own conclusions.

ARGUMENT.

I.

The Relationship of Debtor and Creditor Between Employer and Employee, Existing at the Inception of the Transactions in Question Persisted Throughout, Notwithstanding the Failure of the Bankrupt Company to Carry Out Its Promise to Pay to the Welfare Association a Sum Equivalent to Amounts Charged Against the Employees, Less Deductions for the Expenses of the Association Paid by the Bankrupt Company.

Maurice Paradise, as Trustee, the respondent herein, appears as the representative of approximately three thousand former employees of the Grigsby-Grunow Company (R. 1-2). His rights, however, are not, strictly speaking, the rights of the individual employee, except to the extent of their joint and collective rights as members of the association, and to the extent that said former employees as members of the association are entitled to a pro rata distribution of the assets of the Majestic Employees' Welfare Association and its successor, the Majestic Works Council. (R. 3.) Maurice Paradise, as Trustee is, therefore, standing in the shoes of the Majestic Employees' Welfare Association, or its successor the Majestic Works Council, and is not, strictly speaking, standing in the shoes of the individual members of the Association or the Council. The relationship between the employees and the Grigsby-Grunow Company was that of debtor and creditor, the employees furnishing labor and other services to the Grigsby-Grunow Company for which the Grigsby-

Grunow Company, either expressly or impliedly, agreed to pay a stipulated amount for same. If the Grigsby-Grunow Company had failed to pay the amount due to the employees, the employees would have been relegated to an action at law on contract, and such failure of the Grigsby-Grunow Company could hardly be said to have amounted to a conversion and to subject the company to an action in trover.

The Majestic Employees' Welfare Association was an unincorporated society of the said employees whose affairs were governed by a board of directors and duly appointed officers of the employees' own choosing (R. 10). The method by which the Grigsby-Grunow Company became indebted to the Majestic Employees' Welfare Association was through a transfer on the books and records of the Grigsby-Grunow Company, i.e. by charging the employees' accounts on the payroll records with the amount of the weekly deductions of twenty-five cents and crediting the aggregate of all said amounts to the account of the Majestic Employees' Welfare Association (R. 11). No money was ever turned over or paid to the Grigsby-Grunow Company by its employees to be held by it for the benefit of the Majestic Employees' Welfare Association. The legal effect of this situation amounted to nothing more than a transfer of an account receivable due from the Grigsby-Grunow Company to its individual employees to an account receivable due from the Grigsby-Grunow Company to the employees jointly and collectively comprising the Majestic Employees' Welfare Association. In other words, merely an equitable assignment of a chose in action from the individual employee to the Majestic Employees' Welfare Association, and nothing more, and insofar as these bankruptcy proceedings are concerned, the account lost its right to priority of payment in bankruptcy by the expiration of the three-month period as fixed by Section 64 (b) 5 of the Bankruptcy Act. The failure of the Grigsby-Grunow Company to pay to the Welfare Association a sum

equal to amounts charged against the employees' accounts, less deductions for expenses of the Association paid by the bankrupt company was nothing more than a breach of contract for which the bankrupt company was liable at the suit of the Welfare Association in contract.

In the case of *Susan M. Bayor* v. *American Trust & Savings Bank,* Assignee, 157 Ill. 62-68, the Supreme Court of Illinois, on facts which are dissimilar to the case at bar, but which are in point by way of analogy as to the issue of law, held as follows:

> "Where the relation between the parties is primarily that of a debtor and creditor and there is a mere unperformed agreement on the part of the debtor to create a specific fund which shall possess a separate entity, and to hold the same in trust, it would be illogical and inconsistent with these adjudications to hold that such a creditor occupies a stronger position than one who is primarily the beneficiary of a distinct and identified trust fund."

The trust fund referred to in the above case is one created by an assignment of the debtor of its assets to the American Trust & Savings Bank for the benefit of its creditors.

It is to be noted that in the case of *Bayor* v. *American Trust & Savings Bank,* Assignee, supra, there was an agreement on the part of the debtor to create a specific fund which was to possess a separate identity, and to hold the same in trust. In the instant case there is nothing in the record of these proceedings to show that there was ever an express agreement to create a trust or that a specific fund was to be created possessing a separate identity, so that it appears that the Supreme Court of Illinois has gone much farther on this point than this court will be required to do under the existing state of facts.

In the case of *People* v. *Illiana State Bank,* 265 Ill. App. 29, the Appellate Court followed the decision of the Supreme Court of Illinois in the case of *Bayor* v. *American*

Trust & Savings Bank in holding that a trust relationship does not come into being by reason of a mere unperformed agreement where the relationship between the parties is primarily that of debtor and creditor.

In the case of *Colegrove & Co. Bank* v. *Gaupp,* 357 Ill. 499, the Supreme Court of Illinois held that to create a trust there must be a res in existence upon which the trust can act, and the mere execution and delivery of a declaration of trust is not sufficient to create a trust if, in fact, no res exists upon which it may operate.

It would, therefore, follow from the above that the relationship of debtor and creditor existing at the inception of the transactions in question persisted throughout and that the claim of the Majestic Employees' Welfare Association, and its successors, including that of Maurice Paradise, as Trustee is one based upon contract and, therefore, entitled only to participate in the Grigsby-Grunow Company bankruptcy estate as a general creditor.

II.

A Transfer of Accounts by Mere Bookkeeping Entries, Such as the Debiting of a Number of Accounts and the Crediting of Another Account Without Segregation of Some Specific or Identifiable Property Does Not Create a Fund Which Can be Traced, or Which Can be Said to Augment the Assets of an Estate Coming Into the Hands of a Trustee in Bankruptcy.

1. A transfer of accounts by mere bookkeeping entries, such as the debiting of a number of accounts and the crediting of other accounts, without segregation of some specific or identifiable property, does not create a fund which can be traced, or which can be said to augment the assets of an estate coming into the hands of a trustee in bankruptcy. The rule has thus been stated in *Brownell* v. *Turman,* 75 F. (2d) 913, 915:

"In order for appellee's claim to be allowed as a preference it was necessary to establish (1) that the funds claimed by him were impressed with a trust in his favor, (2) that there was an augmentation of the assets of the bank by virtue of the collection of his bonds, and (3) that the augmented assets have been traced into the hands of the receiver, and not merely into the general assets of the bank. See *Blakely* v. *Brinson*, 286 U. S. 254, 52 S. Ct. 516, 76 L. Ed. 1089, 82 A. L. R. 1288; *First National Bank* v. *City of Miami*, (C. C. A.) 69 F. (2d) 346; *Allied Mills* v. *Horton* (C. C. A.) 65 F. (2d) 708, 90 A. L. R. 1." (*Brownell* v. *Turman*, 75 F. (2d) 915.)

In the case of *Blakely* v. *Brinson* 286 U. S. 254-63 above referred to the relationship of debtor and creditor existed between a bank and its depositor on October 14, 1929 for the sum of $1961.31. The bank, through its officer, agreed to purchase $4000.00 of United States Bonds for the depositor and requested the depositor to deposit an additional $2100.00 to cover the cost of the United States Bonds. This the depositor did, thus increasing his deposit balance to $4061.31. The officer of the bank represented to the depositor that the bonds had been ordered and later advised him that the bonds had been purchased and handed to him a charge slip which stated that they were charging his account with $3964.60, being the purchase price of the United States bonds. The bank charged the depositor's savings account on its books with said sum and credited a like amount as a deposit in a bond account appearing on its books. When the bank closed its doors it was discovered that in fact no bonds had been purchased, ordered or received for the depositor. On these facts the District Court concluded that the bank had received the $3964.60 in trust for the purpose of purchasing the bonds, and that as the funds in the hands of the receiver had been augmented by the wrongful commingling of the trust funds with the other funds of the bank, the depositor was entitled to payment in preference to the general creditors

of the bank, the Circuit Court of Appeals affirming. The receiver of the bank took the position that no trust ever came into existence as the result of these transactions. This court, considering the effect of the bookkeeping entries, held as follows:

> "The cancellation of the credit balance by the debit neither suggests any intention to establish a trust nor points to any identifiable thing which could be the subject of it."

In the case of *Mechanics' & Metals National Bank of City of New York* v. *Buchanan,* 12 F. 2d 891 (CCA 8) a preferential claim against funds of the bank in the hands of a receiver was sought on the ground of a trust fund theory. In said case, as well as in the present instance, no payments in money were, in fact, made—the transactions being a mere bookkeeping transfer. Citing from page 892, the court held:

> "It is conceded that no payments in money were in fact made; therefore, the funds of the bank were not augmented in any way. The original notes were not taken up in whole or in part, but was left in the possession of appellant, which had no notice of the transaction prior to insolvency. A mere bookkeeping transfer was made which would have been effective perhaps if the bank had continued as a going concern, but by which the funds of the bank were in no respect augmented. It consisted merely of a shifting of credits on the books of the bank. The rule applicable is thus announced in *Beard* v. *Independent District of Pella City* (CCA 8) 88 F. 375, 31 C. C. A. 562.
>
> "It is indispensable to the maintenance by a cestui que trust of a claim to preferential payment by a receiver out of the proceeds of the estate of an insolvent that clear proof be made that the trust property or its proceeds went into a specific fund or into a specific identified piece of property which came to the hands of the receiver. The case made by appellant falls short of this requirement. Transactions upon which it relies consisted of a mere shifting of credits

> on the books of the insolvent bank. The assets of that bank were not increased thereby, nor were any funds set apart which, or any part of which, came into the hands of the receiver."

In the case of *Thompson* v. *Common School District,* 67 F. 2d 284 the Circuit Court of Appeals for the Ninth Circuit held that a bank's use of trust property or funds in such a way as merely to decrease its liabilities, as by using checks to pay its debts to other banks, does not augment assets in its receiver's hands as required to entitle beneficiary to priority.

To the same effect see *State Bank of Winfield* v. *Alva Security Bank,* 232 F. 847 (CCA 8), and *Beard* v. *Independent District of Pella City,* 88 F. 375 (CCA 8).

2. The federal courts have long followed the rule of "augmentation of assets" and have held that a transfer of accounts by mere bookkeeping entries, without actual segregation is not sufficient because it does not augment the assets of the estate and consists merely of a shifting of credits. The stipulation of facts clearly shows that there never was a trust fund; that no money passed between the employees and the Grigsby-Grunow Company so that there was nothing that ever existed which could be commingled or be the subject of a conversion.

In the case of *Edisto National Bank of Orangeburg* v. *Bryant,* 72 F. 2d 917-919 the Circuit Court of Appeals for the Fourth Circuit in an exhaustive opinion held as follows:

> "Trusts are not declared in vacuo because of a trust relationship. They must be predicated of particular property.
>
> (Citing Cases)
>
> And the record before us shows no property as to which a trust could have been predicated. The failure of the bank to segregate funds or set aside securities may have been a breach of legal duty on its part, but it certainly resulted in no identifiable res which could be declared the subject of a trust. As was well said by

Judge Sibley in *Wisdom* v. *Keen*, (CCA 5) 69 F. 2d 349-350 'Equity if dealing with the bank alone might well consider that it had done what it should have done and might well hold it to the consequences. * * * But in dealing with the distribution of the assets of an insolvent national bank and with the requirement of ratable dividends to all claimants, a more stringent adherence to what was actually done is proper. Here the bank agreed to segregate a trust res but never did it. By their mutual intent the bank's relation to Keen was that of a trustee rather than a debtor, but there is still no identifiable trust res traceable as such but only a liability for a breach of trust in failing to create the res.' As plaintiff has failed to show that the bank received in trust an identifiable res with respect to which a trust could be declared, it necessarily follows that it has failed to trace any such trust fund in the hands of the receiver or to show any augmentation of assets in his hands resulting from the conversion by the bank of such trust funds. This is fatal to the establishment of a trust against the assets in the hands of the receiver.

(Citing Cases)

The learned judge below was of the opinion that there had been a sufficient tracing of the funds under the rule laid down in *Schumacher* v. *Harriett*, 52 F. 2d 817 for the reason that it was admitted that the savings deposits of the bank at all times exceeded $19,000.00. But there can be no tracing of a trust fund where there was no trust fund in the first instance to trace, and even if there had been such a fund, the savings deposits of the bank which were liabilities and not assets would not assist in the tracing. Where a trust fund is shown to have been in existence and to have been converted by the bank, it may be segregated if it can be traced into an identifiable fund such as the cash of the bank; but here there could be nothing of that sort as no trust fund was shown to exist. When the bank qualified as executor, it was indebted to the estate of Bryant for the funds which had been deposited with it and there was no aumentation of its assets as a result of its qualification. At most there was a mere shifting of credits which could not serve

as a basis of a trust on the theory of augmentation." (Citing Cases)

In the case of *Santee Timber Corporation* v. *Ellott,* 70 F. 2d 179-183, the Circuit Court of Appeals for the Fourth Circuit held as follows:

> "Because of the importance of the question involved we have gone somewhat fully into the question as to the existence of a trust; but even if the bank were held a trustee of the funds covered by the deposits, complainant has not established any right to subject to the trust any of the assets which came into the hands of the receivers. As heretofore stated, the deposits in question were made by crediting to the Sales Agreement Account checks drawn by the hardware company against its general account in the bank. This resulted in a mere shifting of credits and added nothing to the bank's assets. There was consequently no augmentation of assets upon which a trust in favor of complaint could be predicated." (Citing Cases)

The Court's decision in *Santee Timber Corporation* v. *Elliott,* above quoted, was approved in *City Council of Charleston, S. C.* v. *Elliott,* 73 F. (2d) 920, 921, wherein the Court went so far as to hold that where the city had opened a special account with the bank for the payment of tax notes and the bank paid interest on the deposit balances but mingled the deposits with its other funds, there was no trust established even though the bank had asserted that the deposits constituted a trust fund and had promised but had failed to furnish security.

To the same effect is *State Bank of Winfield* v. *Alva Security Bank,* 232 F. 847, 849, quoted with approval in *Harry E. Jones, Inc.* v. *Kemp,* 74 F. (2d) 623, as follows:

> "The capital defect, however, of plaintiffs' theory is their treatment of the grand division of the bank's assets in its reports known as 'Cash and Sight Exchange 'as a fund' within the law relating to the following of trust funds. To adopt that theory is to re-establish under a mere bookkeeping disguise the

exploded notion that a trust fund may be recovered if it can be traced into the general assets of an insolvent estate. The courts have shown a tendency to restrict the 'trust fund' doctrine. *Empire State Surety Co.* v. *Carroll County,* 194 F. 593, 114 C. C. A. 435; *Board of Commissioners* v. *Strawn,* 157 F. 49, 84 C. C. A. 553, 15 L. R. A. (N. S.) 1100; *In re Brown* (C. C. A.) 193 F. 24; *Commercial National Bank* v. *Armstrong* (C. C.) 39 F. 684. The rule is accurately stated and numerous authorities cited by this court in the first case referred to, as follows:

" 'It is indispensable to the maintenance by a cestui que trust of a claim to preferential payment by a receiver out of the proceeds of the estate of an insolvent that clear proof be made that the trust property or its proceeds went into a specific fund or into a specific identified piece of property which came to the hands of the receiver.' " (*Harry E. Jones, Inc.* v. *Kemp,* 74 F. (2d) 627.)

In the case of *Swan* v. *Childrens Home Society of West Virginia,* 67 F. 2d 84-87 the Circuit Court of Appeals for the Fourth Circuit held as follows:

"But even if it be assumed that the bank is to be deemed a trustee of the fund covered by the deposit, plaintiff has not established any right to subject to the trust any of the assets which came into the hands of the receiver. It is conceded that no part of the fund has been traced into any specific investment or securities of the bank, and in addition to this it positively appears that no fund which has come into the hands of the receiver could have been augmented as a result of the deposit here in question. As heretofore shown, this deposit was made by the administrator giving the bank a check on his deposit account. This account was not a trust fund held by the bank, but an ordinary deposit account evidencing an indebtedness of the bank which upon insolvency would have stood upon the same basis as other deposits.

(Citing Cases)

And the check to the bank resulted in a mere shifting of credits and added nothing whatever to its assets.

There was consequently no augmentation of assets upon which a trust could be predicated." (Citing Cases)

These propositions of law if standing alone are sufficient to afford the basis of denying priority to the claim of Maurice Paradise, as Trustee. It has always been the rule in the federal courts that before a prior claim can be allowed against the assets of an insolvent, the funds coming into the hands of the receiver or trustee must have been augmented by funds or property of the claimant, and that a transfer effected by mere bookkeeping entries, does not augment the assets of the estate. The court below in its decision in this case entirely ignored the question with respect to the requirement of the augmentation of assets rule, although this point was raised both in the briefs filed and in the oral argument before the court so that the question was properly before the court.

III.

The Federal Rule of "Augmentation of Assets" as Applied to Estates of Insolvents Should be Extended to Estates Being Liquidated Under Federal Bankruptcy Proceedings, Since the Theory of Said Type of Proceedings is to Secure an Equal Distribution of Assets Among All the Creditors of the Insolvent and to Prevent Preferences.

The Circuit Court of Appeals in its decision in this case seeks to distinguish this case from the cases cited on the ground that in the cases cited by your petitioner, the parties sought to be held as trustee were national banks, and that the national bank statutes and the regulations of the national bank department governing the liquidation of insolvent banks are confirmatory of the relationship of debtor and creditor between depositor and bank.

It is respectfully urged that the Circuit Court of Appeals has overlooked the fact that the Bankruptcy Act is

an exercise of the constitutional authority of Congress to the same extent as the National Banking Acts and that the purpose of both the National Banking Act and the Uniform Bankruptcy Act is primarily to secure an equal distribution of assets among all of the creditors of the insolvent and to prevent preferences.

In the case of *Stratton* v. *New*, 283 U. S. 318-320, this court speaking through Justice Roberts held as follows:

> "The purpose of the bankruptcy law passed pursuant to the power of Congress to establish a uniform system of bankruptcy through the United States was to place the property of the bankrupt, wherever found, under the control of the court for equal distribution among the creditors."

In the case of *Wood* v. *A. Wilbert's Sons Shingle & Lumber Co.*, 226-234 U. S. 324, this court speaking through Justice McKenna held as follows:

> "The Bankruptcy Act is very comprehensive of the whole subject of bankruptcy. It creates courts of bankruptcy and is full in its provisions for the collection and preservation of the estate of the bankrupt through trustees appointed by creditors, who are given power to bring suits to recover the property of the bankrupt which has been conveyed by him in fraud of his creditors, or to give a preference to any of them; the purpose of the Act being to secure an equality of distribution of the assets of the bankrupt among his creditors."

To the same effect see:

Clark v. *Rogers*, 228 U. S. 534;
Pirie v. *Chicago Title & Trust Co.*, 45 L. Ed. 1171;
Boese v. *King*, 108 U. S. 379.

This court has also held that the primary purpose of the National Banking Act is to secure an equal distribution of assets among all of the creditors of the insolvent and to prevent preferences.

In the case of *Jennings* v. *United States Fidelity & Guaranty Company,* 294 U. S. 216-226; the court held as follows:

> "As applied to a national bank, the preference is plainly inconsistent with the system of equal distribution established by the Federal Law."

In the case of *Adams* v. *Champion,* 94 U. S. 231-239, the court held as follows:

> "The assets of the bank were now held by the receiver upon a trust for equal distribution."

It, therefore, appears from the above cited cases that the purpose of the Uniform Bankruptcy Act and the National Banking Act is identical and that the cases under the National Banking Act should be applicable to cases under the Uniform Bankruptcy Act. If so the frequently reiterated rule should be applied as stated in *Atlantic Gypsum Co.* v. *Federal National Bank of Boston,* 76 F. (2d) 59, 61;

> "The liquidation of national banks is controlled by statute; and the statute is distinctly unfriendly to the recognition of special interests or preferred claims. R. S. Sec. 5236 (12 USCA Sec. 194); *Cook County Nat. Bank* v. *U. S.,* 107 U. S. 445, 450, 2 S. Ct. 561, 27 L. Ed. 537. Doubts should be resolved against them. *Blakely* v. *Brinson,* 286 U. S. 254, 52 S. Ct. 516, 76 L. Ed. 1089, 82 A. L. R. 1288; *Texas & Pacific Ry. Co.* v. *Pottorff,* 291 U. S. 245, 54 S. Ct. 416, 78 L. Ed. 777; *First National Bank* v. *Miami,* (C. C. A.) 69 F. (2d) 346, 349." (*Atlantic Gypsum Co.* v. *Federal Nat. Bank of Boston.* 76 F. (2d) 61.)

IV.

A Mere "Indebtedness or Liability to Account" Cannot be the Subject of Trover or Conversion Since Only Tangible Property Can be the Subject of Conversion.

The court below in this case appears to have predicated its decision on the theory that the bankrupt was guilty of conversion of property of its employees and, therefore, stood in the position of a trustee ex maleficio. It speaks of "money" deducted from the wages of the employees, and "funds" and "dollars" which the bankrupt failed to turn over to the Welfare Association, while in fact no actual money was involved. Quoting from the decision rendered (R. 32):

> "Instead of turning over to the welfare association the money deducted from the employees' wages, the bankrupt converted it to its own use. It credited itself with the payment of the amount and yet retained the said sum in its own treasury. This was a conversion."

Again—(R. 33):

> "What bankrupt did was to take the money, the amount of which was the unpaid wages of its employees, from one pocket and transfer the same money to another pocket, and to announce in legal effect, that in this sum it was now indebted to the welfare association. It should have paid it to the association. It was guilty of conversion when it did not do so."

Again—(R. 33):

> "Such a trust so created (a constructive trust, a trust ex maleficio) will not fall though other dollars may take the place of the original ones received when the employees made their contribution to the fund."

Again—(R. 35):

> "Such a trust, equity will follow even though there has been a commingling of the trust fund with private accounts."

No coin or other specie of money is involved in the transaction in question. The employees performed labor and services for which they were entitled to compensation, for the payment of which the Grigsby-Grunow Company was legally liable. Up to the time of actual payment, no coin or other specie of money was involved. The bank accounts of the Grigsby-Grunow Company represented merely an obligation on the part of the respective banks to pay a given amount to the Grigsby-Grunow Company on demand and a relationship between the Grigsby-Grunow Company and its banks was clearly one of debtor and creditor. In the absence of money, i.e. actual coin or specie, there was nothing that the Grigsby-Grunow Company could convert, or which could be the subject of conversion. The following text quotations are illustrative of the true principles involved:

> "The general principle must, however, not be ignored that trover lies for the conversion of money only when there is an obligation resting on the defendant not to convert to his own use specific coin or notes."
>
> 26 RCL 1102, Note 8.
>
> "Trover will not lie for a general debt."
>
> 50 ALR 1171.
>
> "Only tangible property is subject to conversion."
>
> Cooley on Torts—4th Edition, Volume 2, page 498.

While in the instant case there is nothing of a tangible nature which could be the subject of conversion, it is also true that money is the subject of conversion only where there is an obligation on the part of the recipient to return the specific money entrusted in his care.

> "Hence, trover will not lie for money delivered to one person to be expended in behalf of another and by the former converted to his own use."
>
> 26 RCL 1102—Note 9.

> "Trover will not lie for money which was given to the defendant to be used for a particular purpose and which the defendant converts to his own use."
> Cooley on Torts, 4th Edition, Volume 2, Section 330, page 496.

In the case of *Shrimpton & Sons* v. *Culver,* 109 Mich. 577 67 NW 907, The Supreme Court of Michigan, held as follows:

> "Trover is not maintainable for money unless there be an obligation on the part of the defendant to return the specific money entrusted in his care."

In the case of *Larson* v. *Dawson,* 24 RI 317, 53 ATL 93; 96 Am. St. Rep. 716, the Supreme Court of Connecticut held that trover for conversion of money will not lie where there was no duty resting on defendant to keep the money intact in specie.

In the case of *Rothschild* v. *Schwarz,* 59 NYS 527-528 the Supreme Court of New York held as follows:

> "Conversion has reference to specific articles of property which are owned by plaintiff, or to which he has the right of immediate possession. It does not apply to money when the receipt of it creates only a debt to the plaintiff as in the case at bar. An action for conversion cannot be maintained against a person who receives money in a fiduciary capacity unless he is bound to turn over the identical money."

In the case of *Kovusch* v. *Lowenberg,* 185 SW 747-748 the St. Louis Circuit Court of Appeals held as follows:

> "Money is the subject of conversion only when it can be described or identified; as a specific chattel."

To the same effect see:

> *Anderson Electric Car Co.* v. *Savings Trust Co.* 212 SW 60.

In the case of *Kerwin* v. *Thomas J. Balhatchett,* 147 Ill. App. 561-565 money was voluntarily given to the defendant

to do certain things with—to pay himself the debt which plaintiff owed him and then to discharge other specified indebtedness of plaintiff and to account to her for the balance. Suit was instituted against the defendant in trovel for conversion and judgment was rendered for the plaintiff. The Appellate Court in reversing and setting aside the judgment says as follows:

> "The relation of debtor and creditor was thus created between them. Trover lies for specific chattels wrongfully converted and not for money had and received for payment of debts. It does not operate on chattels generally but specifically such as money in coin or bills, animals or other property capable of identification as being the actual property or thing wrongfully taken and converted."

The court below cited the following from *Jennings* v. *U. S. F. & G. Co.*, 294 U. S. 216-224: (R. 33)

> "Dollars are fungibles and any one of them will be accepted as a substitute for another."

No fault can be found with this doctrine. However, in speaking of dollars as being fungibles, this court was referring to a situation where actual dollars were received and commingled with other dollars. Preceding the above quotation was the following:

> "Currency paid over the counter and deposited in a vault is a thing that can be identified and so subjected to a trust whenever in equity and conscience a trust should be implied. Not only that, but a trust so created will not fail though other dollars may have taken the place of those originally received, for dollars are fungibles and any one of them will be accepted as a substitute for another."

This court in the same case pointed out the distinction between a situation where actual dollars are received and commingled, and where nothing has been received which could be commingled. Reading from the opinion, page 224:

"But the situation is very different when what has been received by the collecting agent is not a thing at all but a reduction of liabilities by set-off or release.

(Citing Cases)

"A debt does not furnish a continuum upon which a trust can be imposed after cancellation or extinguishment has put the debt out of existence."

It is respectfully urged that the Circuit Court of Appeals misconceived both the nature of the transaction in the instant case and the doctrine of trover and conversion, and that in holding that the Grigsby-Grunow Company was a trustee ex maleficio because of said alleged conversion plainly erred.

V.

The Property Coming Into the Hands of a Trustee in Bankruptcy is not Charged With a General Lien in Favor of the Claimant Even Though the Bankrupt Might be Held to Have Been a Trustee Ex Maleficio.

The decision of the court below in effect holds that where a constructive trust is created, i.e. a trust ex maleficio, all of the property of the trustee is charged with the claim of the cestui que. This theory is against the weight of authority as will appear from an examination of *St. Louis & S. F. R. Co.* v. *Spiller,* 274 U. S. 304-309. In said case a railroad company had exacted illegal freight rates, which it was subsequently ordered to repay to the shipper. The Court of Appeals held that the railroad company became liable as trustee ex maleficio for the overcharges and that this liability was enforceable as upon a constructive trust; the only claim made that the money collected could be traced into the hands of the receiver was that throughout the ten years which elapsed between the earliest exaction and the transfer of properties to the new company, the old one and the receiver had at all times in the several banks on which checks for various expenses were drawn, a working balance

in the aggregate largely in excess of the shipper's claim. This court in passing upon said contention, in its opinion on pages 309 and 310 held as follows:

> "The assertion that the money collected can be traced into the receivers hands is confessedly without any support except the stipulated fact that throughout the ten years which elapsed between the earliest exaction and the transfer of the properties to the new company, the old one and the receiver had at all times in the several banks on which checks for current expenses were drawn, a working balance in the aggregate, largely in excess of Spiller's claim. Such a showing fails to bring the present case within the rule by which, when trust funds are mingled with others, the cestui may assert an equitable lien upon the mingled mass to the extent of his contribution thereto."
>
> (Citing Cases)
>
> "An illegal exaction does not impress an indelible trust upon all funds which the wrong-doer and his successors may thereafter have on deposit in their banks. For aught that appears all the money illegally exacted may have been spent for current operating expenses."

In the case of *Spokane County* v. *First National Bank of Spokane,* 68 F. 979 (CCA 9) the court held: (quoting from syllabus)

> "The owner of property entrusted to another by whom it has been misapplied is not entitled to a general lien upon the assets of the trustee for the value of such property, but can only follow the same so far as it can be traced, either in its original form or in other forms into which it has been converted."

In the case of *Burgoyne* v. *McKillip,* 182 F. 452-454 (CCA 8) (Cert. denied 55 L. Ed. 605) the court held as follows:

> "Although a demand may be founded on a breach of trust, the entire estate of the recreant trustee is not thereby necessarily impressed with a trust."

In the case of *Samuel Little and Others* v. *Joseph H., Chadwick and Others*, 151 Mass. 109-110, the court held:

> "When trust money becomes so mixed up with the trustee's individual funds that it is impossible to trace and identify it as entering into some specific property, the trust ceases. The court will go as far as it can in thus tracing and following the trust money but when as a matter of fact it cannot be traced, the equitable right of the cestui que trust to follow it fails. Under said circumstances, if the trustee has become bankrupt, the court cannot say that the trust money is to be found somewhere in the general estate of the trustee and still remains. He may have lost it with property of his own and in such case the cestui que can only come in and share with the general creditors."

In the case of *Worchester Bank & Trust Co., Trustee* v. *Robert A. Nordblom,* 285 Mass. 22-25, the court held as follows:

> "Apart from statute, in the distribution of the assets of an insolvent or deceased trustee, a claim based on the duty of the trustee or its breach is entitled to no priority because of its origin. Inherently a claim upon a grocery bill or promissory note ranks as high. It is only where some of the assets can be shown to be a part of the trust estate, or the product of the conversion of specific funds, or property of the trust estate into another form, that the trust estate can obtain an advantage over the creditors generally. That advantage is not a right to priority or preference but rather a right to reclaim assets of the trust estate that can be traced and found."

In the case of *Macy* v. *Roedenbeck,* 227 F. 346-352 (CCA 8) the Circuit Court of Appeals for the Eighth Circuit held as follows:

> "The ownership of this note and the fact that Roedenbeck was the owner of the proceeds of its collection, after the proceeds had been misapplied by the Bank of Sully to whom it had been entrusted, did not entitle Roedenbeck to a general lien upon the assets of the

> trustee in bankruptcy of such bank for the value of such property. He can only follow the note or the proceeds of the collection so far as it can be traced in its original form or in other forms into which it has been converted."

In the case of *Zenor* v. *McFarlin*, 238 F. 721 (CCA 8) the Circuit Court of Appeals for the Eighth Circuit held as following (reading from the syllabus):

> "One who delivered grain to a warehouseman, who subsequently became bankrupt after selling the grain is not entitled to a preference for the value of the grain, unless there is clear proof that the proceeds of the sale went into a specific fund or into specifically identified property, which came into the hands of the trustee in bankruptcy, it not being sufficient that it went into the general assets of the bankrupt and thereby increased his estate."

In the case of *In re Morris Brothers, Inc.*, 293 F. 294-296 (CCA 9) the Circuit Court of Appeals for the Ninth Circuit held as follows (reading from the syllabus):

> "One who as a result of fraud paid money to bankrupt corporaton which went into its general funds and was used in its business and cannot be traced into any property in the hands of its trustee, cannot establish a trust which entitles him to preference over general creditors."

We have shown by the above cited cases that even if the Grigsby-Grunow Company is held to be a trustee ex maleficio that it would not necessarily follow that Maurice Paradise, as Trustee was entitled to priority of payment in these bankruptcy proceedings since there never was a trust fund or res which could be the subject of a trust. The law is clear that the mere fact that the insolvent was a trustee ex maleficio does not create a general lien upon all of its assets or a lien upon its bank accounts where such lien is sought to be enforced against assets coming into the hands of a trustee in bankruptcy for the benefit of all creditors.

VI.

In Bankruptcy Proceedings, if a Claim for Priority of Payment Does not Come Within the Provisions of Section 64(B) of the Bankruptcy Act, the Claimant is not Entitled to a Prior Claim Unless he can Establish That Property Belonging to Him Came Into the Estate and is Traceable in the Hands of the Trustee in its Original or Substituted Form.

1. The law is well settled that even assuming a trust fund actually existed, before it can be followed and recovered in bankruptcy proceedings, it must be clearly traced and identified in some specific fund or property coming into the hands of the trustee in bankruptcy, and that the burden of proof in tracing said fund rests upon the claimant thereto. These principles have been upheld in the following cases involving bankruptcy proceedings:

In the matter of *J. Albert See, Bankrupt*, 209 F. 172 (CCA 2)
In re *McIntyre & Co.*, 185 F. 96 (CCA 2)
In re *Newark Shoe Stores, Inc.*, 3 Fed. Sup. 293 D. C. Md.

In the case of *J. Albert See, Bankrupt*, 209 F. 172-174 (CCA 2) the Circuit Court of Appeals for the Second Circuit held as follows:

> "It is well known that there are some conflicts of authority upon the question as to whether a trust fund can be followed only when the specific subject matter can be clearly traced or identified or whether it will be sufficient if it can be shown that it has found its way into the assets although it cannot be identified in any particular fund or property. The better doctrine, and that sustained by weight of authority, is that a trust fund can be followed and recovered in bankruptcy only when it can be clearly traced and identified in some specific fund or property coming into the hands of a receiver or trustee in bankruptcy."

In the case of *In re McIntyre & Co.*, 185 F. 96 the doctrine of following trust funds is discussed and the Circuit Court of Appeals for the 2nd Circuit made the following comment:

> "While the doctrine of following trust funds has been much extended in the modern decisions there has never been a departure in the Federal courts from the principle that there must be some identification of the property sought to be charged with the trust funds."

In the case of *Newark Shoe Stores, Inc.*, 3 Fed. Sup. 293-295 approximately three hundred employees of the Newark Shoe Stores, Inc., Bankrupt, filed prior claims in said bankruptcy proceedings based upon deposits of $200.00 which each of said employees had made with the bankrupt as security for the faithful performance of their duties, and which amount was to be returned to them upon termination of their employment. These deposits were collected over a period of fifteen years and were commingled with other deposits of the bankrupt. At no time were the aggregate balances of the combined bank accounts of the bankrupt less than approximately $68,000.00, more than enough to discharge the amount of said deposit claims. The employees contended that they were entitled to priority on either of two grounds—first, that the deposits were in the nature of trust funds to which the bankrupt company does not obtain any beneficial title and—second, that the deposits were entitled to priority upon general equitable principles. The court held that the deposits were in the nature of trust funds, although not entitled to priority on so-called general equitable principles, but further held it would not necessarily follow that all or any of the deposits should be refunded. Quoting from the decision:

> "No deposit can be, unless at the present time, it is definitely traceable into one of the company's bank accounts, and only if it can be shown that such bank account has never been less than the amount of such de-

posit and that the funds in that account have come into the hands of the trustee in these bankruptcy proceedings."

(Citing Cases)

"The apparent hardship of the rule herein announced is regrettable, but courts may not, without warrant, extend the clearly defined limitations of the Bankruptcy Act and create preferred creditors, in derogation of the rights of general creditors."

This decision was decided on authority of *St. Louis & S. F. R. Co.* v. *Spiller,* 274 U. S. 304-309.

In the case of *Schuyler* v. *Littlefield, Trustee,* 232 U. S. 707-710 the Supreme Court laid down the following propositions:

"Where one has deposited trust funds in his individual bank account and the mingled fund is at any time wholly depleted, the trust fund is thereby dissipated and cannot be treated as reappearing in sums subsequently deposited to the credit of the same account.

One seeking to charge a fund in the hands of a trustee for the benefit of all creditors as being the proceeds of his property and, therefore, a special trust for him, has the burden of proof and if he is unable to identify the fund as representing the proceeds of his property, his claim must fail as all doubt must be resolved in favor of the trustee who represents all creditors."

These principles also find support in the decision of the court in the case of *St. Louis & S. F. R. Co.* v. *Spiller,* 274 U. S. 304-309, and in the following cases.

In the case of *Colegrove & Co. Bank* v. *Gaupp,* 357 Ill. 499-505 the Supreme Court of Illinois in October 1934 held as follows:

"The right to reclaim a trust fund is founded on the right of the ownership of the fund on the part of the party claiming the same to have it restored to him by the party having possession of the fund. Such claim

is not based upon the relationship of debtor and creditor or tort feasor, but is bottomed solely on ownership. Therefore, to recover as a cestui que, the owner or beneficiary of the trust property must prove that the alleged trustee has, in fact, the property even though it be in an altered form. Failing in this the trust fails, and the claims, if there is any legal liability therefor, becomes merely one of compensation on the same plane as other general debts."

In the case of *Harmer* v. *Rendelman*, 64 F. 2d 422-423, the question as to the tracing of trust funds was fully considered by the Circuit Court of Appeals for the 4th Circuit, the court holding as follows:

"The old rule with regard to the tracing of trust funds wrongfully misapplied, or the proceeds or property wrongfully converted, was that the right ceased when the property was turned into money and mixed and confounded in the general mass of property of the same description."

(Citing Cases)

"The modern rule, however, is that where such property or proceeds has gone to swell the aggregate in the possession of the fraudulent party, it may under proper proceedings, be segregated in amount from such aggregate sum, and made the subject of a trust, in order to accomplish the ends of justice."

(Citing Cases)

"But there is a limitation upon this modern rule as well setlled as the rule itself, viz; that it is not sufficient to prove merely that the trust property has gone into the general estate and has presumably increased its amount and value. It is indispensable that clear proof be made that the trust property or its proceeds has gone into a specific fund or into a specific identified piece of property, or has directly augmented a fund upon which the trust is to be declared. When it is sought to impress funds in the hands of a receiver with a trust on account of the wrongful conversion of trust property by an individual or corporation to whose rights he has succeeded, it must be shown that the funds in his hands have been directly augmented by

the presence of the trust property or its proceeds, so that a court of equity can see with certainty that the trust property is in his hands."

In the case of *Hanna* v. *Consolidated School District No. 1*, 78 F. 2d 374-377 (CCA 8), the Circuit Court of Appeals for the Eighth Circuit held as follows:

"The diligence of counsel has not disclosed any case in the Eighth Circuit where this court has deviated from its invariable rule that the claimed trust fund must be clearly proven to have gone into the fund in the receiver's hands before preference will be awarded. We think it equally clear that in so adhering this court has conformed to the mandate of the Supreme Court decisions."

(Citing Cases)

In the case of *Swan* v. *Childrens Home Society of West Virginia*, 67 F. 2d 84-88 the Circuit Court of Appeals for the Fourth Circuit held as follows:

"It is the contention of plaintiff that where a trust relationship is established, no augmentation or tracing need be shown, but that because of relationship, the cestui que trust is given preferential status in the distribution of the assets in the hands of the receiver. We do not concede this to be the law. The policy of the National Banking Act is to secure equality of treatment to the creditors of an insolvent bank and there is no such thing as a 'preferred claim' under the statute. 12 USCA 194. Those entitled to trust funds held by the bank may enforce the trust against the receiver, not on the ground that the law gives them a preferred status but that the receiver has property which in equity and good conscience belongs to them. But unless they can trace the trust funds into some fund or specific property which has come into his hands or can show that the assets in his hands have been directly augmented as a result of the conversion of the trust funds by the bank, they have no basis upon which relief can be granted them."

(Citing Cases)

It has been clearly shown that the claimant has not established that property belonging to him came into the estate and is traceable into the hands of the trustee in bankruptcy in its original or substituted form. That being the case, the claim to be entitled to priority of payment therefore must come within the provisions of Section 64 of the Bankruptcy Act, particularly Section 64 (b) 5 thereof, which is as follows:

> "The debts to have priority in advance of the payment of dividends to creditors and to be paid in full out of bankrupt estates, and the order of payment shall be (5) wages due to workmen, clerks, traveling or city salesmen, or servants, which have been earned within three months before the commencement of the proceeding, not to exceed $600.00 to each claimant."

Thus, Congress has limited the claims of the employes in bankruptcy proceedings. However, it is to be noted that the claim filed by Maurice Paradise, as Trustee is not predicated upon wages, and the proceedings before the Referee, the District Judge and the Circuit Court of Appeals were not conducted upon the wage claim theory. Congress never intended the claims of employees to be treated on a different basis than claims of other persons, except to the extent provided for in said Section 64 (b) 5. Section 17 (a) 6 of the Bankruptcy Act provides in effect that a discharge in bankruptcy shall release a bankrupt from all of his provable debts except such as are "(6) Due for moneys of an employee received or retained by his employer to secure the faithful performance by such employee of the terms of contract of employment" it is significant of the intention of Congress in this respect that while such claims are exempted from the effect of a discharge, Congress did not see fit to grant priority of payment for same.

2. The effect of the decision of the court below is to allow a claim in a bankruptcy proceeding which clearly did not come within the classification of claims entitled to priority

as established by Section 64 (b) of the Bankruptcy Act as amended. The claim also could not be sustained upon the theory of reclamation of property belonging to the claimant, therefore the decision must be said to rest upon general principles of equity jurisprudence.

In the case of *Burton Coal Co.* v *Franklin Coal Co.*, 67 F. 2d 796 (CCA 8) the court held as follows (page 797):

> "Some question is raised as to the equity jurisdiction of the Bankruptcy Court. That it is a court of equity in the sense that its judges and referees in adjudging the rights of parties entitled to their decision are governed by principles and rules of equity jurisprudence is beyond question."
>
> (Citing Cases)
>
> "It has not, however, plenary jurisdiction in equity but is confined in the application of the rules and principles of equity to the jurisdiction conferred upon it by the provisions of the Bankruptcy Act reasonably interpreted."
>
> (Citing Cases)
>
> "The plain mandate of the law cannot be set aside because of considerations which may appeal to the Referee or Judge as falling within general principles of equity jurisprudence."

In the case of *Southern Bell Telephone & Telegraph Company* v. *R. B. Caldwell*, 67 F. 2d 802 (CCA 8) the claimant sought priority of payment on equitable grounds. The referee in passing on the question held that Section 64 (b) is exclusive as to classes of debts which are entitled to priority of payment in advance of payment of dividends to creditors and that the petitioner's claim did not fall within any of the classes as set forth in said section. The Circuit Court of Appeals in said case sustained the contention of the Referee, citing with approval its former decision in the case of *Burton Coal Co.* v. *Franklin Coal Co.*, 67 F. 2d 796 (CCA 8).

The court below has not cited a single case which is contrary to the principles enunciated in the cases cited in this

brief. The case of *Jennings* v. *U. S. F. & G. Co., supra* has been heretofore distinguished, and in fact sustains the propositions urged herein. The case of *Standard Oil Co. of Ky.* v. *Hawkins,* 74 F. 397 (CCA 7) is not in point. In this case the claimant could trace funds belonging to him in the hands of a receiver of a bank, but prior to claimant making a claim to said funds, the receiver had disbursed the same to general creditors, and the court merely held that the claim of the claimant was not defeated thereby since the other assets in the hands of the receiver were sufficient to discharge the claim. Reading from the opinion (page 399):

> "The receiver is a trustee holding these funds for distribution among the creditors of the bank according to their respective rights. He is an officer of the law. Equity will not permit a trustee to avail himself as against a cestui que trust of a mistake of law on the part of the latter when it is possible to correct the error without injury to the trust estate. Here it is true the specific money of the appellant is no longer in the hands of the receiver. It has been distributed by him in the proper discharge of his duty among the creditors; but as the property of the appellant was erroneously, although through no fault of the receiver appropriated to the benefit of the general creditors, there is no injustice in a restoration, if assets remain out of which indemnification can be had. The general creditor will receive not a penny less than is his due. The appellant if the remaining assets prove sufficient and availing will receive that to which it is entitled and no more."

The case of *Gorman* v. *Littlefield,* 229 U. S. 19 is a stock brokerage case and is not in point. In said case for a year or more before the failure of the stock brokerage house, claimant was a customer dealing with one of its Chicago offices, buying stocks on margin and also paying for them in full. The claimant directed the Chicago office to buy 250 shares of Green Cananea Copper stock for him. The stock

was bought on the understanding that it was to be paid for in full and at the time the order was executed the claimant had an ample credit balance with the firm applicable on its books to the payment in full of the shares purchased. The certificates of stock were left by the claimant in the possession of the broker, subject to claimant's further order. The stock was purchased and certificates received for same by the broker. The actual certificates of stock were later hypothecated in various manners by the broker. At the time of the petition in bankruptcy, the receiver in bankruptcy and then the trustee came into possession of certificates endorsed in blank for an aggregate of 350 shares of Green Cananea Copper Stock. As to this stock no claim had been filed with the receiver or the trustee, although the time for filing claims had expired. This court, therefore, held that the certificates of stock were not the property itself, but merely the evidence of it and that a certificate for the same number of shares represented precisely the same kind and value of property as a certificate for a like number of shares in the same corporation; that the substitution of one share for another made no material change in the property right of the customer and that a stock broker when selling shares of stock purchased by him for third persons is obligated to buy others of like kind and keep same on hand, subject to the order of the customer. There being no other claimants for said certificates, the claimant was entitled to receive the 250 shares out of the 350 shares on hand at the time of bankruptcy.

The case of *Knatchbull* v. *Hallett*, 13 Ch. Div. 696 is not in point, since in said case by the terms of a marriage settlement the sum of 2300 pounds was actually placed in the hands of trustees. Several changes were made in the investment of the fund, the fund being first invested in a mortgage which was later paid off and then invested in Russian 5 per cent Bonds. The Russian Bonds were subsequently sold by Hallett, who came into possession of the

fund, and the proceeds deposited by him in his bank account. It, therefore, appears that a fund created by the payment of money to trustees in trust was created, which was subsequently traced into the bank account of Hallett. The doctrine of this case was, therefore, a question of tracing a trust *res* and the consideration of the question as to whether the commingling of the fund in the bank account of the trustee destroyed the right of the *cestui que* to follow and reclaim the same.

The Circuit Court of Apeals has not cited a single case, nor has the respondent all through these proceedings, where a claimant has been allowed priority of payment in a bankruptcy proceeding, or in any other insolvency proceeding, where the only claim of the creation of a fund has been in the shifting of debits and credits on the books of an insolvent.

VII.

Where the Findings of a Referee Are a Deduction From Established Facts, or Uncontradicted Evidence, the Judge is at Liberty to Draw His Own Inferences and Deduce His Own Conclusions.

The findings of the referee quoted by the court below were not binding upon the district judge or the Appellate Courts. The findings of fact and conclusions of law made by the distinguished referee were based upon a stipulation of facts and undisputed testimony and it is sometimes stated that findings by a referee are presumptively correct and will not be disturbed unless they are clearly against the weight of evidence or some obvious error of law has intervened in its application. However, this rule does not apply to inferences to be drawn from admitted facts.

In the case of *In re Solof*, 2 F. 2d 130-132 the Circuit Court of Appeals for the Ninth Circuit held as follows:

> "No doubt, findings by a referee in bankruptcy are presumptively correct and will not be disturbed unless

they are clearly against the weight of evidence or some obvious error of law has intervened in its application. This rule, however, has little application to inferences to be drawn from admitted facts. In the present case if every controverted question of fact was resolved in favor of the trustee, the question still remained—Was a preference intended? and the court was fully as competent to determine that question as was the Referee and had the same opportunities. In the case of Ohio Valley Bank Co. v. Mack 163 F. 155, is the following opinion: 'Much in both cases must depend upon the character of the finding. If it be a deduction from established fact, the finding would not carry any great weight for the judge having the same facts may as well draw inferences or deduce a conclusion as a referee.'"

In the case of *In re Sullivan Condensed Milk Co.*, 291 F. 66-68 (CCA 7), the court held as follows:

> "This is not a case where the court saw and heard the witnesses whose testimony is conflicting. It is a case where the facts are stipulated and we are to make deductions from the stipulated facts. The findings of the referee are, therefore, entitled to no more weight than the stipulated facts warrant."

The court below in its opinion says as follows (R. 36):

> "The employees did not know whether the money had been turned over to the Welfare Association or not. The Welfare Association did not know how much had been deducted from the employees' wages. It is elementary that no waiver of rights or ratification of wrongful actions can occur without knowledge of the facts."

This is a mere assumption on the part of the court below and there is nothing in the record from which this conclusion could be drawn. The stipulation of facts clearly showed that the Welfare Association was governed by its own officers and directorate and maintained its own account in The First National Bank of Chicago (R. 10). It also showed that commencing with February 4, 1933 the

bankrupt began to fall in arrears, which continued until November 24, 1933; that during said time the officers of the Welfare Association had made demands upon the bankrupt for payment of the amount due it but that no action was taken by the Welfare Association or its successors until the bankrupt was placed in equity receivership and a claim filed by Maurice Paradise, as trustee therein. It would, therefore, follow that the employees through their own officers in the association had knowledge of the entire situation and in the absence of a showing of any protest acquiesced in the manner in which the transaction in question was handled.

CONCLUSION.

We have previously called attention to the fact that the primary purpose of the Bankruptcy Act is to provide for equality of distribution among the creditors and to prevent preferences. Therefore, those charged with the duty of administering a bankruptcy estate must look first to the Bankruptcy Act when determining the classes of claims which are entitled to priority of payment. If a claim does not come within any of the classifications of Section 64 (b) of the Bankruptcy Act, the sole question presented is whether any property belonging to third persons, or the proceeds of such property, came into the hands of the trustee. In such a case a claimant sustaining the burden of identifying his property, or the proceeds thereof, is entitled to reclaim his property. The court's attention is called to the fact that the trustee in bankruptcy no longer stands in the shoes of the bankrupt with respect to property of the bankrupt coming into his custody, but is also vested with all of the rights, remedies and powers of a creditor holding a lien by legal or equitable proceedings thereon. (Section 47 (a) 2.) It would indeed be a dangerous precedent for courts to resort to legal fictions in order to grant priority to claims not otherwise granted priority of pay-

ment by the Bankruptcy Act and so far as the other general creditors of an estate are concerned, it would be manifestly unfair to them since they obviously can have only such rights in a bankruptcy estate as the Bankruptcy Law provides.

The decision of the court below is erroneous and should be reversed.

Respectfully submitted,

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Nos. 4-5
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CHARLES ELMORE

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, A. D. 1935

Nos. ~~785-786~~

IN THE MATTER OF GRIGSBY-GRUNOW, INC.,
Bankrupt.

FRANK M. McKEY, Trustee in Bankruptcy,
Petitioner,

vs.

MAURICE PARADISE, as Trustee,
Respondent.

Answer to Petition for Writ of Certiorari.

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IN THE

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OCTOBER TERM, A. D. 1935.

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vs.

MAURICE PARADISE, as Trustee,
Respondent.

Answer to Petition for Writ of Certiorari.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

As pointed out by the petitioner, the facts underlying this controversy were the subject of a stipulation between the parties (R. 12-15). However, three observations should be made:

1. There were at all times sufficient sums in the bankrupt's bank accounts to pay the moneys due the Majestic Employees Welfare Association (R. 15).

2. The right to deduct the initial membership fee and the weekly dues from the salaries and wages of the employees of the bankrupt was a condition of employment imposed by the bankrupt (R. 12).

3. Until February 4, 1933 the bankrupt fully performed its obligations to its employees by promptly remitting the accumulated payroll deductions to the Majestic Employees Welfare Association. During the period from February 4, 1933 until November 24, 1933, while there was always a balance due from the bankrupt to the Association, the bankrupt partially performed its obligation (R. 12-13).

It is apparent, we feel, that this is not the kind of case called to the attention of the Court in the petitioner's citation of authorities, where a bank has failed to obey directions of a depositor to use certain money in the depositor's account for the purchase of securities or for other special purposes; nor like the case of *St. Louis S. F. R. Co.* v. *Spiller*, 274 U. S. 304-309, 71 L. E. 1060-67, where the dispute was between shippers of freight and a railroad on the question of excessive rates, in a controversy which is vastly different on the facts from the case at bar; nor like the case of *In re Newark Shoe Stores, Inc.*, 3 Fed. Sup. 293 (D. C. Md.) where *store managers* were required to deposit certain moneys as *security* for the faithful performance of their duties and where the employer while *authorized* to hold the moneys deposited, intermingled them with its other funds.

The duty of the bankrupt to segregate and remit the accumulated payroll deductions faithfully and *promptly* in order that the moneys could be used for the purposes of providing life, health and accident benefits for the bankrupt's employees and their families (R. 12) cannot fairly be compared with the duty devolving upon a bank dealing

with a depositor, or a railroad dealing with shippers, or a chain store concern dealing with moneys deposited as security with it by its store managers. If it be urged that there is a similitude in legal theory, a realistic analysis requires the acknowledgment that the difference in degree is so vast as to result in a difference in kind. It is difficult to conceive of a situation where the relationship between the parties, the nature of the obligation and the purpose of the undertaking would impose a higher fiduciary duty than in the instant case.

Then too, unlike any of the cases cited by petitioner, the instant case presents a trust relationship which rests not merely in acts promised for the future, but on the contrary here there was full performance of the bankrupt's fiduciary obligation for a long period of time and partial performance almost until the very day the Equity Receivers took possession of the bankrupt's business (R. 12-13). Thus we are not dealing here with obligations and duties merely promised and totally unperformed, but with obligations and duties performed in part and in part uncompleted.

The Circuit Court of Appeals, we submit, correctly analyzed the instant case in its opinion, in the following language:

> "Such transactions, we think, resulted in the creation of a trust, a constructive trust, a trust *ex maleficio*, which was fastened upon the bankrupt irrespective of its intention. When it deducted the twenty-five cents per week and the one dollar initiation fee, it was under obligation to turn the same over to the Majestic Employees Welfare Association. This it did for several years. But, with failure and bankruptcy confronting it, resort was had, as is so frequently the case, to subterfuge—to an attempt to despoil or dis-

possess those whose numbers were many and whose individual interests were small. Instead of turning over to the welfare association the money deducted from the employees' wages, the bankrupt converted it to its own use. It credited itself with the payment of the amount and yet retained the said sum in its own treasury. This was a conversion.

The turning point in the case is the transaction whereby bankrupt indebted to individual employees for wages took the same and satisfied its indebtedness to them and then failed to turn the money over to the beneficiary. Bankrupt's right to credit itself with the unpaid wages was dependent upon its payment of said sum to the welfare association.

What bankrupt did was to take the money the amount of which was the unpaid wages of its employees from one pocket and transfer the same money to another pocket, and to announce, in legal effect, that in this sum it was now indebted to the welfare association. It should have *paid* it to the association. It was guilty of conversion when it did not do so. The legal effect of such transaction was to make it a trustee *ex maleficio.*" (R. 43-44.)

While it may be true that it is necessary for the Court to invoke fictions and presumptions in order to impress a trust upon the assets of the bankrupt, certainly it must be conceded they are implements of justice which are indispensable to avoid consequences which would be shocking to equity and conscience. *Adams* v. *Champion*, 294 U. S. 231, 238. It is incredible that the malfeasance of the employer in failing to perform its fiduciary obligation to its employees and in converting the moneys from their wages and salaries to its own use, can be availed of by the

Trustee in Bankruptcy so that the moneys wrongfully held and retained by the employer will be disbursed to the general creditors of the bankrupt.

We respectfully submit that the petition for writ of certiorari should be denied by this Honorable Court.

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STANFORD CLINTON,
Of Counsel.

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1936

No. 4

FRANK M. McKEY, TRUSTEE IN BANKRUPTCY,
Petitioner,

vs.

MAURICE PARADISE, AS TRUSTEE,
Respondent.

No. 5

FRANK M. McKEY, TRUSTEE IN BANKRUPTCY,
Petitioner,

vs.

MAURICE PARADISE, AS TRUSTEE,
Respondent.

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR RESPONDENT.

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ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR RESPONDENT.

SUPPLEMENTARY STATEMENT OF FACTS.

To the statement of the case by petitioner, there should be a short supplement.

Subsequent to February 4, 1933, when the bankrupt commenced to withhold the moneys which it had undertaken to remit to the Employees' Welfare Association, the respondent, as the representative of the Association, requested of Leroy J. Williams, vice-president and general manager of the bankrupt, and M. D. Harrison, treasurer of the bankrupt, that the sums due the Association be paid. Payment, however, was never made. Later the respondent requested payment from the Equity Receivers and payment was refused.

With reference to the bank accounts of the Grigsby-Grunow Company, the practice of the bankrupt was to deposit all of its incoming revenue in its general bank account, from which it would from time to time withdraw moneys and establish various special accounts. The bankrupt was accustomed to withdraw from its general account or special accounts, as the convenience of the situation required, and the payroll was drawn from the various accounts, both general and special, indiscriminately.

The foregoing supplementary statement is undisputed between the parties and was stipulated to by them (R. 13).

Position of Respondent.

Respondent's theory of the case is that the accumulated deductions from the payroll of the bankrupt's employees, and which the bankrupt had failed to remit to the Employees' Welfare Association, constituted a trust fund in the hands of the bankrupt and that the trust fund can be sufficiently identified as part of the bankrupt's bank accounts.

Under respondent's theory of the case it is unnecessary to follow the somewhat elaborate classification of points

adopted by petitioner in his brief. Eliminating unnecessary and incidental theoretical minutiae, the instant case presents for the determination of the Court just two questions, namely: Was there a trust or fiduciary relationship between the bankrupt and its employees, and, assuming the existence of such a trust relationship, can the trust *res* or fund be sufficiently identified to allow the respondent to impress a preferential lien on the moneys in the bankrupt's bank accounts which came into the possession of the Trustee in Bankruptcy? Respondent insists that a trust relationship existed between the bankrupt and its employees and that the trust fund, under the facts stipulated between the parties, is clearly and sufficiently identified.

SUMMARY OF ARGUMENT AND AUTHORITIES IN SUPPORT THEREOF.

I.

The relationship between the bankrupt and its employees was that of trustee and cestui que trustent.

Southern Cotton Oil Co. v. *Elliott,* 218 F. 567;
Perry on Trusts and Trustees (7th Ed.) Vol. 1, Sec. 2;
Ballantine Law Dictionary (1930) p. 1303;
26 R. C. L. (1929) p. 1168;
Bogert's The Law of Trusts and Trustees (1935), Sec. 1.

II.

The moneys constituting the trust fund can be sufficiently identified.

Knatchbull v. *Hallet,* 13 Ch. Div. 696;
Central National Bank v. *Conn. Mutual Life Ins. Co.,* 104 U. S. 54;
Adams v. *Champion,* 294 U. S. 231;
Schumacher v. *Harriett,* 52 F. (2d) 817;
Schuyler v. *Littlefield,* 232 U. S. 707;
Jennings v. *United States Fidelity & Guaranty Company,* 294 U. S. 216;
People, ex rel. Oscar Nelson v. *The Peoples State Bank of Maywood,* 354 Ill. Sup. 519;
Mercantile Trust Co. v. *St. Louis, etc. R. R.,* 99 F. 485;

Alexander v. *Fidelity Trust Co.*, 249 F. 1;
Peters v. *Bain*, 133 U. S. 670;
Madras Official Assignee v. *Krishnagi Bhat*, 49 Times Law Reports 432;
Canadian Bar Review, June 1934 issue, pages 379 to 382;
Standard Oil Co. of Ky. v. *Hawkins*, 74 F. 397;
People, ex rel. Oscar Nelson v. *Peoples Bank and Trust Company*, 353 Ill. 479;
Gorman v. *Littlefield*, 229 U. S. 19;
Duel v. *Hollins*, 241 U. S. 523.

ARGUMENT.

I.

The relationship between the bankrupt and its employees was that of trustee and cestui que trustent.

The respondent predicates his right to a preferential lien against the bank accounts of the bankrupt, not in reliance upon any priorities provided for in the Bankruptcy Act, but on the theory that the bankrupt was holding the sum of $14,607.51 in the capacity of a trustee acting for the benefit of its employees.

It is undisputed law that a trustee in bankruptcy does not take title to any property which a bankrupt held as trustee and not individually. *Southern Cotton Oil Co.* v. *Elliott,* 218 F. 567. In this case the court held that where it appears that trust moneys have been mingled with the general funds of a depositor in a bank and the account has not in the interval been depleted below the sum comprising the trust fund, the final amount will be presumed to include the trust funds and title thereto in the hands of the trustee in bankruptcy is subject to the preferential lien of the beneficiary.

The petitioner does not quarrel and has not at any stage of the proceedings challenged respondent's statement of law that if the fund here in question be found to be a trust fund, that the Trustee in Bankruptcy did not acquire any title or interest therein. Indeed, all of the cases cited by petitioner proceed on the premise that if a trust fund is in existence and can be identified, the beneficiaries of the

trust are entitled to the full amount thereof from the fiduciary administering the particular insolvent estate in question.

The respondent contends that the relationship between the bankrupt, Grigsby-Grunow, Inc., and its employees was clearly that of trustee and *cestui que trustent*. A trust may be defined as "an obligation upon a person arising out of a confidence reposed in him to apply property faithfully and according to such confidence." Perry on Trusts and Trustees (7th Ed.) Vol. 1, Sec. 2; Ballantine Law Dictionary (1930) p. 1303; 26 R. C. L. (1929) p. 1168. In the instant case the bankrupt undertook the obligation of collecting the accumulated payroll deductions from its employees, segregating and remitting them promptly to the Majestic Employees Welfare Association. The entire plan, conceived and put into effect by the bankrupt, contemplated the welfare of the bankrupt's employees and their families by providing life, health and accident benefits for them. It should be remembered that the Majestic Employees Welfare Association was not only organized and maintained by the bankrupt, but that the bankrupt required all of its employees to participate in the plan and that it undertook through its facilities to make the requisite collections and to remit them to the Association. In order that the purposes of the Association could be consummated without an impairment of capital through unfortunate investments, it was stipulated that the funds of the Association should be, and as a matter of fact they were, invested solely in obligations of the United States Government. Here then is a situation where a large employer of labor initiates and puts into effect an insurance program for the benefit of its employees, in the course of which large sums of money accumulated from the wages and earnings of the employees are in the custody of the employer, who has

undertaken to transmit them to an agency set up by the employer to administer insurance benefits to the employees and their families. Beset by financial stringencies, the employer, in breach of its obligations, fails and neglects to remit the funds in accordance with its undertakings. As a result, when creditors close in and first Receivers in Equity and then the Trustee in Bankruptcy take over the assets of the concern, the employees find that their employer has been faithless to its trust and has comingled and confused their moneys with its own.

In Bogert's The Law of Trusts and Trustees (1935) Section 1, the author, in defining a trust, declares it to be "a fiduciary relationship in which one person holds a property interest, subject to an equitable obligation to keep or use that interest for the benefit of another * * *. A fiduciary relation is one in which the law demands an unusually high standard of ethics or moral conduct with reference to another * * *. *The ethics of ordinary business relations, where parties oppose each other at arm's length, do not apply to the trust.*"

The petitioner insists that the relationship between the employees and the employer was that of debtor and creditor; in other words, that they were dealing with each other at arm's length. In support of this, we submit, utterly untenable position, the petitioner assumes as a fact (petitioner's brief Point I) that the relationship of debtor and creditor existed at the inception of the transactions in question and that this relationship "persisted throughout." Petitioner's assumption is fallacious for the simple reason that *at the inception of the relationship there was no debt owing to the employees.* The right of the company to deduct the initiation and weekly dues was a condition of the contract of employment. The contract entered into

prior to the time the employee had any sum or sums due him, simply amounted to this: "We (the employer) will pay you so much compensation. If you stay with us for thirty days we will automatically, without consulting you or obtaining other or different consent or authorization than your acceptance of employment, deduct from your wages, membership dues for the Employees' Welfare Association. We maintain this Association in connection with our business and we require all of our permanent employees, that is, those who are employed for more than thirty days, to be members of this Association. In short, if you wish to work for us permanently, you must be a member of the Employees' Welfare Association. However, important advantages are conferred upon you by membership in the Association: you are assured of life, health and accident insurance benefits. After the thirty day period we will pay *you* so much and we will pay to *the Welfare Association,* for your use and benefit in terms of insurance protection, so much. To absolutely insure the safety of the funds, the Association will make investments only in obligations of the United States Government."

Having accepted employment under these terms, the employee was not entitled to receive the moneys deducted from his salary or wages. He had submitted to an arrangement whereby the bankrupt was to *use the deductions for his benefit by turning over the deductions to the Association maintained by the bankrupt.* To put it differently, legal title to the deductions was in the bankrupt, charged with the equitable obligation to apply the deductions in accordance with the terms of its undertaking to its employees. It is therefore clear that neither at the inception of the relationship between the parties, nor thereafter, was there a debtor-creditor relationship between the employer and the employees with reference to this fund.

The cases of *Susan M. Bayor* v. *American Trust & Savings Bank, Assignee,* 157 Ill. 62, *People* v. *Illiana State Bank,* 265 Ill. App. 29, and *Colegrove & Co. Bank* v. *Gaupp,* 357 Ill. 499, cited by petitioner involve facts utterly dissimilar from the case at bar. In each of these cases there was *originally a debtor-creditor relationship between the banks and their depositors or customers.* Unperformed promises to change this relationship were held insufficient to alter the status of the parties. In the instant case, not only did the contract of employment contemplate a trust relationship, but the fact is that up until February of 1933 the obligations arising from the relationship *were faithfully discharged.*

Respondent insists that the "ethics of ordinary business relations, where parties oppose each other at arm's length" do not apply here; that there existed here "an obligation upon a person arising out of a confidence reposed in him to apply the property faithfully and according to such confidence."

To view the relationship between the bankrupt and its employees as anything less than trustee and *cestui que trustent,* is, we submit, to completely ignore first, the confidential and fiduciary character of the relationship of an employer (and particularly a large employer) to its employees, second, the dependence upon the employer by the employee that the undertaking of the employer would be faithfully discharged, and third, the hopeless impossibility of the employees learning of, insisting upon and protecting their rights. To describe sums of money culled from employees at the instance, even more, upon the insistence and by direct act of the employer, to be used for the purpose of insurance benefits for them and their families, as a mere debt owing from the employer to the employees, and to

classify the claim of the employees with debts or accounts receivable incidental to ordinary commercial transactions, is, we urge, utterly contrary to every precept of the law of fiduciary obligation.

II.

The moneys constituting the trust fund can be sufficiently identified.

Assuming, as we feel this court will, that the relationship between the bankrupt and its employees was that of trustee and *cestui que trustent*, can the trust fund be sufficiently traced and identified so that a preferential lien can be allowed to the claimant? The history of this problem affords a pointed illustration of how courts over a period of time will whittle away at an enunciated rule of law which in its application leads to many unjust results, until the hardship of the rule is greatly minimized or entirely eliminated. Thus no more than a century and a half ago it was a settled legal proposition that moneys which had been confused or comingled by a fiduciary with other funds belonging to the fiduciary, could not be followed unless the claimant could specifically identify the money which belonged to him. This rule, which almost invariably tended to defeat recovery, was a natural incident of the more basic doctrine that in order for beneficiaries of a trust to follow a trust *res* they had to be able to identify it in specie. This situation naturally resulted in many decisions which seemed to defeat justice. The requirement that the claimant had to earmark or identify particular bills or coins before he could be permitted to recover, effectively cut off beneficiaries of trusts from recovering that which admittedly belonged to them, but which had been misappropriated or misused by unfaithful trustees or fiduciaries.

Finally, the earmark doctrine was distinctly discarded and repudiated in the leading case of *Knatchbull* v. *Hallet*, 13 Ch. Div. 696. There it was held, to quote the summary of the case by Mr. Justice Matthews in *Central National Bank* v. *Conn. Mutual Life Ins. Co.*, 104 U. S. 54, at pages 68 and 69, that:

> "If money held by a person in a fiduciary character, though not as trustee, has been paid by him to his account at his banker's, the person for whom he held the money can follow it and has a charge on the balance in the banker's hands although it was mixed with his own moneys. * * * The modern doctrine of equity as regards property disposed of by persons in a fiduciary position is that whether disposition of it be rightful or wrongful, the beneficial owner is entitled to the proceeds whatever be their form, provided only he can identify them. If they cannot be identified by reason of the trust money being mingled with that of the trustee, then the *cestui que trust* is entitled to a charge upon the new investment to the extent of the trust money traceable into it; that there is no distinction between an expressed trustee and an agent, or bailee, or collector of rents, or anybody else in a fiduciary position, and there is no difference between investments in the purchase of lands, chattels, or bonds, or loans or moneys deposited in a bank account. * * * Equity will follow * * * money even if put into a bag or indistinguishable mass, by taking out the same quantity, and the doctrine that money has no earmark must be taken as subject to the application of this rule. (Furthermore) the rule in Clayton's case (1 Mer. 572) attributing the first drawings out to the first payments in, does not apply; * * * the drawer must be taken to have drawn out his own money in preference to the trust money."

The doctrine announced by the *Hallet* case is now a well-settled law of general application. *Schumacher* v. *Harriett*, 52 F. (2d) 817; *Schuyler* v. *Littlefield*, 232 U. S. 707; *Central National Bank* v. *Conn. Mutual Life Ins. Co.*, 104 U. S. 54; *Jennings* v. *United States Fidelity & Guaranty Company*, 294 U. S. 216; *Adams* v. *Champion*, 294 U. S. 231; *People, ex rel. Oscar Nelson* v. *The Peoples State Bank of Maywood*, 354 Ill. Sup. 519.

In the case of *Mercantile Trust Co.* v. *St. Louis, etc. R. R.*, 99 F. 485, the court says:

> "It is now the settled doctrine that co-mingling a trust fund with the private funds of the trustee does not destroy the right of the *cestui que trust* to follow it; the co-mingling being wrong, the entire fund is impressed with the trust, and as long as an amount equal to the trust fund remains in the co-mingled mass, the same and all of it to the extent of the trust fund will be made to respond to the claim of the *cestui que trust*. The last-mentioned rule is in perfect correspondence with the rule first announced requiring the *cestui que trust* to show that his money or property is in the hands of a trustee; it simply enlarges the rule and allows recovery when and so far as the communal fund in which the trust fund has been inextricably confused is found in the hands of the trustee."

The case of *Alexander* v. *Fidelity Trust Co.*, 249 F. 1, again serves to illustrate the principle. In that case the court said, at Page 10:

> "The court's attention has not been called to any authority holding that, as against the *cestui que trust*, the trustee can set up his own failure to set apart

trust funds, and say: 'I converted your money to my own use long ago by mixing it with my own. True, I have ample to pay you, which is the product of the co-mingled funds, but I do not know which is yours and which is mine. You did not consent that I should do so, nor did you know that I did so, but by converting it to my own use I made you a mere creditor and the statute of limitations has run against your claim.'

"As found by the Master, the intent of the decedent to commingle the trust funds with his own was not one which the donor contemplated, nor the law sanctions, and cannot bind the *cestui que trust* without his consent or knowledge."

Another often cited authority in this connection is the case of *Peters* v. *Bain*, 133 U. S. 670. In this case, at page 693, the court approved the following statement of the rule:

"Formerly the equitable right of following misapplied money or other property into the hands of the parties receiving it depended upon the ability of identifying it, the equity attaching only to the very property misapplied. This right was first extended to the proceeds of the property, namely, to that which was procured in place of it by exchange, purchase, or sale. But if it became confused with other property of the same kind, so as not to be distinguishable without any fault on the part of the possessor, the equity was lost. Finally, however, it has been held as the better doctrine that confusion does not destroy the equity entirely, but converts it into a charge upon the entire mass, giving to the party injured by the unlawful diversion a priority of rights over the other creditors of the possessor."

In England, where the earmark doctrine of identification of a trust fund was formerly applied with utmost strictness, the greatest leniency is now shown on the question of identification if a fiduciary relationship has been established.

In the case of *Madras Official Assignee* v. *Krishnagi Bhat,* 49 Times Law Reports, 432 (1933), the claimant's father had 10,000 rubles "lying" to his credit with the firm of T. R. Tawker and Sons, with which the claimant's uncle was connected. The claimant's father directed that the uncle *invest* (italics ours) the money in the firm in the name of the claimant, who was then a minor, the money to be paid to the claimant upon attaining twenty-one years, and the interest in the meantime to be paid to the claimant's father. A receipt was given for the money, which described the fund as "a fixed deposit * * * carrying interest at 9% per annum." The firm encountered difficulties. A suit was instituted in the name of the claimant against the members of the firm, alleging that they were trustees of the fund; asked that they be removed and new trustees appointed in their place, with a direction to hand over the trust fund to the claimant. The defense admitted the trust but alleged that the suit was premature inasmuch as the claimant was still a minor and no breach of trust had been committed.

During the pendency of this case, Tawker and Sons was adjudged insolvent and the Official Assignee, in whom the estate of the insolvent firm was vested, filed a written statement putting the claimant to the proof of the existence and validity of the trust and denying that the claimant was entitled to any preferential claim.

Judgment was given for the claimant and was upheld on appeal in the Appellate Courts of India. On appeal to the

Judicial Committee of the Privy Council, the judgment was affirmed. The Judicial Committee considered "as the only possible question * * * whether the trust fund can be found in the assets of the trustee firm."

The court in its opinion, page 433, stated in part:

> "The trial Judge held on the evidence that the trust fund could be traced into the stock (of the defunct firm). The learned Judges of the Appeal Court were not satisfied that this was established, but they thought that the investment of the trust money in the general assets of the business was sufficient to give the respondent a charge upon the sale proceeds in the hands of the appellant, and in their Lordships' opinion the conclusion to which they came was right. * * *
>
> Assuming, then, that the whole assets of the business, including the 10,000 rubles as invested in it, passed into the hands of the appellant on the insolvency, their Lordships think that they so passed subject to any charge in favor of the respondent to which they may have been subject before the insolvency. * * *
>
> In the present case when once it was admitted that the 10,000 rubles were a trust in the hands of Tawker and Sons to be invested in their business and were so invested, the sum must be taken to have remained a part of the assets of that business and to have been there at the date of their insolvency, the beneficiaries being entitled at all times to a charge upon such assets in the hands of the firm. Upon the insolvency the assets passed to the appellant but passed subject to the charge."

In commenting on this decision, D. G. Farquharson, in the June 1934 issue of the Canadian Bar Review, pages 379 to 382, says in part:

"The recent decision of the Judicial Committee is an important and far reaching pronouncement on the rights of a *cestui que trust* in the following of trust funds, whether or not the same have become intermingled with and are indistinguishable from the property of the trustee, and whether or not the trust funds have been dealt with in accordance with the terms of the trust. * * *

It may be concluded that the view of the Judicial Committee is that, not only is it not necessary, in order to be entitled to a charge on the property passing into the hands of the trustees in bankruptcy, that the *cestui que trust* shall be able to follow the *res* of the trust fund into particular assets or a particular fund, but it is incumbent upon the trustee in bankruptcy, if he is to defeat the claim, to prove that the particular *res* of each trust, of which the bankrupt is trustee, has been lost or ceased to exist, *i. e.*, that it has not remained a part of the assets of that business and to have been there at the date of insolvency. This would be difficult, if not impossible, to show in many of our bankruptcies where there have been conversions and yet there remains in the business of the debtor goods, shares or money sufficient to compensate for the various conversions. Furthermore, an old judgment of Turner L. J. in *Pennell* v. *Deffell,* is approved as laying down the correct principle that as between the *cestui que trust* and a trustee or parties claiming under the trustee otherwise than by purchase for valuable consideration without notice, all property belonging to a trust, however much it may be changed

or altered in its nature or character and all the fruits of such property, whether in its original or its altered state, continues to be subject to or affected by the trust."

Under the broad rule laid down by the English court, the right of the claimant to recover here would be beyond dispute. While the United States courts have generally pursued a narrower view, it is a view that has been the subject of increasing liberality in application. *Schumacher* v. *Harriett,* 52 F. (2d) 817; *Schuyler* v. *Littlefield,* 232 U. S. 707.

In *Schumacher* v. *Harriett,* 52 F. (2d) 817, Harriett turned over to her bank two checks aggregating $9,193.02, which were in payment of life insurance on her deceased husband, with directions to invest $8,500.00 of the money in United States Government bonds. The officers of the bank agreed to do this and to credit her account for the amount of the checks above the $8,500.00 necessary to purchase the bonds. The bonds were never ordered and the checks, *without Mrs. Harriett's knowledge,* were credited to a savings account in her name. Six weeks later the bank was closed and taken over by a receiver. It appeared that the bank's balances at its correspondent banks were reduced until at the time of the bank's failure the account with one bank showed an overdraft and that with the other a small balance, which was applied by the correspondent bank on the indebtedness due from the closing bank.

The Trial Court entered a decree which held that the assets of the closed bank came into the hands of its receiver impressed with the trust in favor of Harriett, and directed that her claim of $8,500.00 be paid in full. The

receiver appealed, and in affirming the appeal the Circuit Court of Appeals, Fourth Circuit, said in part:

"The rule is well-settled that where property or funds which are the subject of a trust are used by a bank in such a way as merely to decrease its liabilities and not to augment its assets, no charge upon the assets arises in favor of the *cestui que trust* (citing cases). On the other hand, it is equally well-settled that where a bank, acting as trustee, mingles a trust fund with its other funds, the common fund resulting is impressed with a trust to the amount of the trust fund which has been so co-mingled and lost its identity; and in such case the *cestui que trust* is entitled to have the trust declared and the trust fund separated from the other funds, even though the bank, subsequently to the co-mingling, may have added to and made payments from the common fund, as the presumption is that it respected the trust and did not make payment from the trust property. A limitation upon the rule is that the amount for which the trust is declared may not exceed the smallest amount which the common fund contained subsequent to the co-mingling of the trust funds. * * * The (Harriett's) checks were received by the bank as cash and were treated by it as such. They increased the cash and cash items in the tills of the bank at the time. When it placed them to its credit in Richmond and New York banks it was dealing with them as its own, and the presumption is that cash which was left in its tills was intended to be subject to the trust. While it had, of course, the right to collect the checks, it had no right to place their proceeds to its credit in other banks without holding an equivalent amount in cash in its own vaults to satisfy the trust which it had assumed towards plaintiff; and we

> must assume that it respected the trust, as 'equity imputes an intention to fulfill an obligation' * * * *There is no more reason* * * * *for refusing to declare a trust on the funds remaining than there would be to refuse to do so because the bank had paid out the identical currency which the* cestui que trust *had placed in its possession* * * *. It must be presumed that the intention was that the cash remaining in the vaults of the bank is to be substituted under the trust* * * *.* The duty of courts is to apply the principles of law and equity to the conditions of changing life, and we have no doubt that in view of modern banking practices, the modern but well-settled doctrine of tracing trust funds is applicable to the situation here disclosed."

In the argument below, the petitioner contended that *Schumacher* v. *Harriett, supra,* was overruled in effect by a later decision of this Court in the case of *Blakely* v. *Brinson,* 286 U. S. 254. Respondent insists that there is a vital distinction between the two cases. In *Blakely* v. *Brinson, supra,* the bank's customer *voluntarily* deposited the funds to be used in his account in the regular way. In *Schumacher* v. *Harriett* the understanding between the bank and its customer was that only so much of the proceeds of the checks which were not required in the purchase of the bonds was to be deposited in her account. In other words, a special fund was created out of the money to be used in the purchase of the bonds in the latter case, while in the former case the moneys to be so used were deposited to the credit of the purchaser.

The liberality with which the doctrine of identification is applied is also illustrated by the case of *Standard Oil Co. of Ky.* v. *Hawkins,* Circuit Court of Appeals (Seventh Circuit), 74 F. 397. In this case the complainant deposited

certain funds in a bank at a time when the officers knew it to be hopelessly insolvent. Some considerable time after the receiver appointed by the Controller of Currency had taken possession of the assets of the bank, the complainant filed a claim for the amount of the deposit as an unpreferred claim. In due time a dividend was declared and a check was tendered by the receiver to the complainant for its share. The complainant then consulted counsel, and learning for the first time it might have re-claimed its deposit as fraudulently received, declined the check and filed a bill to set aside its apparent election and to re-claim the amount of the deposit. *It appeared that although the actual funds deposited had been distributed, the other assets of the bank held by the receiver would more than suffice to repay the amount.*

In a carefully reasoned decision, it was held that the complainant should be allowed to re-claim the full amount of the deposit. On page 399 of the opinion and following, the court says:

> "The fund for the creditors was increased by the amount of the proceeds of the securities tortiously obtained from the appellant. This fund was distributed in dividends to the creditors, and, it would seem, about the time the appellant was advised of its right to pursue the proceeds of the securities, and declined to accept its proportionate share. The fact of such distribution is urged as a sufficient reason to deny the relief sought. It doubtless would have that effect if no assets yet remained. * * * however, * * * the receiver has in possession assets of the bank from which he will realize moneys largely in excess of the proceeds of the paper wrongfully obtained by the bank from the appellant, and which went to swell the fund distributed among the creditors. *In such case equity*

should compel restitution of that which has been diverted, and, being unable to lay hold of the specific moneys improperly received, will seek to make restitution out of the assets which remain. The receiver is a trustee holding these funds for distribution among the creditors of the bank according to their respective rights. He is an officer of the law. Equity will not permit a trustee to avail himself, as against a *cestui que trust,* of a mistake of law on the part of the latter, when it is possible to correct the error without injury to the trust estate. Here, it is true, the specific money of the appellant is no longer in the hands of the receiver. It has been distributed by him, in the proper discharge of his duty, among the creditors; but as the property of the appellant was erroneously, although through no fault of the receiver, appropriated to the benefit of the general creditors, there is no injustice in a restoration, if assets remain out of which indemnification can be had. The general creditor will receive not a penny less than is his due. The appellant, if the remaining assets prove sufficient and availing, will receive that to which it is entitled, and no more. There has been an erroneous diversion of the fund,—caused, it is true, by the act of the appellant. If legal injury has resulted from the act, the appellant cannot be afforded relief; but it has not so resulted, and the general creditor will, by the granting of relief to the appellant, be put in no worse plight than before the act. Restoration for diversion of funds, whether from design or through mere error, is not to be denied unless the diversion has occurred through the wrong or error of the party seeking restoration, and when, in the case of error, there has been wrought legal detriment to the opposing right.

This is certainly true with respect to trustees and officers of the law, who are not permitted to assert a mere mistake of law as an excuse for the denial of justice, and who are required to act as any high-minded man would act under the like circumstances."

"Here the receiver is an officer of the law, having the assets *in custodia legis*. He has no interest in the fund, save to see that it shall be distributed among those entitled to it according to the highest principles of honesty and equity. The assets of the bank received by him are, with respect to the question in hand, to be treated as an entirety. Those assets have been swelled by the property of the appellant wrongfully obtained by the bank, and which went into the possession of the receivers. That in the payment of dividends he has disbursed the actual money so received can make no difference, so long as assets remain out of which restitution can be made. The creditors have received that to which they were not entitled, and that which belonged to the appellant. If restitution be made out of the assets still remaining, the creditors will receive no less than that to which they were originally entitled, and the appellant will only receive that which was its due. To compass such a result is the highest equity, since otherwise the appellant will be deprived of its own, and the general creditors will receive that to which they have no right."

The courts of Illinois have adopted a liberal rule in connection with the trust fund cases. In the case of *People, ex rel. Oscar Nelson* v. *Peoples Bank and Trust Company,* 353 Ill. 479, the payee of a check placed it with a local bank for collection. The bank mailed a check directly to the drawee bank with directions to remit, but the drawee bank

instead of remitting the money, sent to the local bank its draft on another bank where the drawee bank had sufficient funds. The drawee bank closed its doors before the local bank was able to collect payment on the draft. The court held that the drawee bank was not directed to remit by draft but only to remit, and its action in sending the draft does not change its relation from that of agent to collect to that of debtor to the payee of the check, and the amount of the check must be regarded as collected and impressed with a trust. The court, on page 485 of its opinion, stated:

> "As to the third point * * * that of tracing the trust fund into the hands of the receiver, there appears to be no dissent among the cases. It is a conclusive presumption in equity that a trustee dissipates or spends his own funds first, before touching or encroaching upon the trust fund. From this it follows that if there was more than the amount of the trust fund on hand at the time the draft was drawn, and at all times thereafter until the closing of the bank, the trust fund must have been included with that which the receiver took over."

It should be noted in this case that there was no segregation of the trust fund and yet the court impressed all of the cash assets of the bank with a preferential lien in favor of the claimant.

An important Illinois case involving the following of a trust fund is *People, ex rel. Oscar Nelson* v. *The Peoples State Bank of Maywood, supra.* In this case the village treasurer, contrary to the state statute of Illinois, deposited with the bank a sum in excess of the indemnity furnished by the bank in the form of surety bonds. The question presented was whether the deposit of these funds which the village treasurer had made knowing that the

bond furnished by the bank was legally inadequate, and accepted by the bank knowing it had not complied with the provisions of the state statute, constituted a trust fund. A divided court held that since the funds were deposited in violation of law, the village was entitled to a preferential lien to the extent that it could trace the moneys in the hands of the bankrupt, and remanded the case for the introduction of evidence on the question of identification. The important point about this case is that the substance of the relationship of the village and bank was that of debtor and creditor and yet the wrongful acts committed resulted in a finding that the bank was a trustee *ex maleficio*.

The case of *Gorman* v. *Littlefield*, 229 U. S. 19, again illustrates the extreme liberality of the present rule with reference to tracing trust property. In this case Gorman, from time to time, gave the bankrupt orders for a certain stock, aggregating *two hundred fifty shares*, and paid for them in full. The books of the bankrupt showed that upon the receipt of each order there was purchased for the account of the plaintiff the number of shares ordered, and certificates therefor were delivered to the bankrupt. The bankrupt, unknown to Gorman, disposed of all of the certificates to various innocent parties. When the trustee took possession of the assets of the bankrupt, there were in the bankrupt estate certificates of the stock in question, endorsed in blank, for an aggregate of *three hundred fifty shares*. The certificates of stock purchased for the benefit of the plaintiff, together with those purchased for other clients, were placed without discrimination in the same tin box. It was customary to take certificates to make delivery from that box, indiscriminately, unless the certificate had been transferred to the name of the customer. As to the stock in the bankrupt estate, no claim had been filed with the trustee, although the time for filing claims had expired.

Both the District Court and the Circuit Court of Appeals held against the plaintiff. The Supreme Court, in reversing the lower courts, declared:

"It is unnecessary for a customer, where shares of stock of the same kind are in the hands of a broker, being held to satisfy his claims, to be able to put his finger upon the identical certificates of stock purchased for him. It is enough that the broker has shares of the same kind which are legally subject to the demand of the customer. And in this respect the trustee in bankruptcy is in the same position as the broker."

"It is said, however, that the shares in this particular case are not so identified as to come within the rule. But it does appear that at the time of bankruptcy, certificates were found in the bankrupt's possession in an amount greater than those which should have been on hand for this customer, and the significant fact is shown that no other customer claimed any right in those shares of stock. It was, as we have seen, the duty of the broker, if he sold the shares specifically purchased for the appellant, to buy others of like kind and to keep on hand, subject to the order of the customer, certificates sufficient for the legitimate demands upon him. If he did this, the identification of particular certificates is unimportant. Furthermore, it was the right and duty of the broker, if he sold the certificates, to use his own funds to keep the amount good, and this he could do without depleting his estate to the detriment of other creditors who had no property rights in the certificates held for particular customers. *No creditor could justly demand that the estate be augmented by a wrongful conversion of the property of another in this manner or the appli-*

cation to the general estate of property which never rightfully belonged to the bankrupt. (Italics ours.)

The ground upon which the Circuit Court of Appeals decided the case seems to have been that the certificates were not sufficiently identified, but as we have said, they were on hand to an amount claimed by the appellant and more, and were not claimed by any other customer. We think there should be no presumption that the stock was stolen or embezzled with intent to deprive the rightful owner of it, and when the unclaimed shares are found in the possession of the bankrupt it is only fair to accept the general presumption in favor of fair dealing and to decide, in the absence of countervailing proof, that the broker out of his funds has supplied the deficiency for the benefit of his customer, which he had a perfect right to do."

In the case of *Duel* v. *Hollins*, 241 U. S. 523, by a divided court it was held that where, prior to insolvency, a brokerage firm purchases for the account of several different customers shares of stock of the same corporation, and at the time it becomes bankrupt it has less than the number of shares in its possession necessary to make a complete distribution to the customers thereto entitled, the shares on hand will be pro rated equally among all of the customers who had purchased and paid for the shares in question.

These two stock brokerage cases deserve the careful consideration of the Court. Here it is perfectly plain that the exact stock to which the customers were entitled could not be identified. Indeed, in *Gorman* v. *Littlefield, supra,* the stock to which the customer was entitled had been disposed of and therefore beyond any doubt did not constitute a part of the assets which passed into the hands of

the trustee in bankruptcy. In the case of *Duel* v. *Hollins, supra,* it is too clear for argument that it was impossible to definitely trace and identify any of the shares of stock to which any one customer was entitled. In each of these cases there was hopeless comingling and, in fact, absolute disposition of the trust *res,* and yet the court permitted recovery.

In the *Gorman* case the court presumed an intention of the stock broker to replace the trust *res* by subsequent purchases of stock. In the *Duel* case the court presumed an intention to restore fractional interests.

The petitioner has cited a number of cases such as *Thompson* v. *Common School District,* 67 F. (2d) 284 (C. C. A. 9), *Edisto National Bank of Orangeburg* v. *Bryant,* 72 F. (2d) 917-919, *Santee Timber Corporation* v. *Elliott,* 70 F. (2d) 179-183, *Swan* v. *Childrens Home Society of West Virginia,* 67 F. (2d) 84-88, and others, to the effect that where there is no augmentation of the insolvent's assets there is not a sufficient identification of the trust fund to permit a claimant to recover a preferential lien against the assets of an insolvent estate.

That this is not a rule of universal application is illustrated by the stock brokerage cases of *Gorman* v. *Littlefield, supra,* and *Duel* v. *Hollins, supra.* Respondent vigorously contends that no stricter rule of identification should be applied to the instant case than to the stock brokerage cases. Certain it is that if the tests invoked in those cases are applied here there can be no doubt as to the respondent's right to a preferential lien. But to accept, for the purpose of argument, the petitioner's contention that the requirement of augmentation is uniformly applied in this type of case and that a mere shifting of credits or decreasing of liabilities does not constitute augmentation, the respondent

urges nevertheless that there is a sufficient showing of augmentation of the bankrupt's assets under the facts presented for the Court's consideration in the instant case.

To begin with, the Court is reminded that the shifting of credits by the bankrupt was part of its malfeasance. It had no right to shift credits. As was forcefully pointed out by the Circuit Court of Appeals in its opinion (R. 33):

> "Bankrupt's right to credit itself with the unpaid wages was dependent upon its payment of said sum to the Welfare Association."

The bankrupt was absolutely obligated to promptly pay over the accumulated deductions to the Association, not to set up an account in favor of the Association on its books. In doing so it converted the fund represented by these accumulated deductions just as surely as though it had taken the money piece by piece from the payroll of its employees and deposited it in its general treasury. As to the requirement of augmentation, the respondent does not contend that the shifting of credits augmented the bankrupt's assets. The contention is that in crediting itself with having paid the employees their wages and by *retaining* the moneys deducted from the employees' wages and salaries, it augmented its assets. Certainly it is beyond controversy that if the bankrupt had discharged its obligations and had paid the money, as it was duty bound to do, to the Welfare Association, there would have been $14,607.51 less in the bank accounts of the bankrupt which were taken over by the Trustee in Bankruptcy.

The petitioner under Point IV of his brief sharply excepts to the language in the opinion of the Circuit Court of Appeals to the effect that the accumulated deductions had been converted by the bankrupt. However, an examination of the authorities cited by the petitioner in support of his position indicates that he has confused the remedy

with the wrong, for he has cited a number of cases to the effect that an action of trover cannot be maintained except to recover specific property which has been converted. We need not elaborate on the point that this is not a trover suit and the respondent's rights to this fund and the nature of the bankrupt's conduct are not to be ascertained by the formal limitations of the action of trover. We heartily subscribe to the determination of the Circuit Court of Appeals that this fund was wrongfully appropriated and converted by the bankrupt.

CONCLUSION.

It is respectfully submitted that in the instant case the trust *res* is subject to sufficient identification to impress a trust on the moneys in the bankrupt's bank accounts to the extent of $14,607.51. As pointed out above, the moneys retained by the bankrupt represented payroll deductions. If it had not been for the arrangement that the accumulated deductions were to be turned over to the Association, the deductions would not have been made and the moneys would have been disbursed in due course as salaries and wages. Three points are conceded under the facts:

(1) That all incoming revenue of the bankrupt was deposited in its general account and that for convenience or other reasons, various moneys were occasionally checked out of the general account and deposited in various special accounts;

(2) That all the accounts of the bankrupt were subject to payroll, and payroll was, from time to time, made by drawing on any or all of the accounts;

(3) That at all times from February 4, 1933 up until the appointment of the equity receivers on November 24, 1933, there were sufficient moneys in the various bank accounts of the bankrupt to more than cover the amount claimed.

In view of these conceded facts, it is submitted that in the instant case there is no difficulty at all in ascertaining the mixed mass of which the trust funds constitute a part. If the moneys had been duly disbursed as part of payroll, the moneys would have been withdrawn from any one of or all of the combined accounts of the bankrupt. It is therefore entirely reasonable and logical to say that these trust moneys can be traced to and identified as part of the general accounts of the bankrupt. It is not necessary that the bankrupt have taken the moneys out of its general funds and then re-deposited them, so long as it can be said with certainty that the trust funds are a part of the banking accounts of the bankrupt.

For the court to deny the appellant's prayer to impress a trust on the bankrupt's bank account to the extent of the claim would be in effect to penalize the employees for the wrongful and tortious act of the bankrupt. It would, in effect, give to the creditors moneys to which they are not entitled and which in fairness, we submit, should be returned to those who placed their trust in their employer to use the moneys in order that they and their families might be safeguarded from misfortune which would deprive them of the capacity or opportunity to earn a livelihood. Not only does every consideration of equity and fair play favor the appellant but in addition it is clear that the creditors are not being deprived of anything to which they are rightfully entitled. The estate is augmented by the funds wrongfully appropriated and retained

by the bankrupt. The moneys are subject to sufficient identification as being part of the bankrupt's bank accounts. There is, therefore, no rule of law or equitable consideration which operates to deny the appellant the right to a preferential lien against the bank accounts of the bankrupt which passed into the possession of the Trustee in Bankruptcy.

It is respectfully urged that, for the reasons given, the judgment of the Circuit Court of Appeals should be affirmed.

Respectfully submitted,

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SUPREME COURT OF THE UNITED STATES.

Nos. 4 and 5.—October Term, 1936.

Frank M. McKey, Trustee in Bankruptcy, Petitioner,
4 *vs.*
Maurice Paradise, as Trustee.

Frank M. McKey, Trustee in Bankruptcy, Petitioner
5 *vs.*
Maurice Paradise, as Trustee.

On Writs of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.

[December 7, 1936.]

Mr. Chief Justice Hughes delivered the opinion of the Court.

The question relates to the propriety of a preference allowed in a bankruptcy proceeding upon the ground of a constructive trust.

The facts were stipulated. The bankrupt, Grigsby-Grunow, Inc., maintained an unincorporated welfare association, known as the Majestic Employees Welfare Association, to provide life, health and accident insurance for its employees. The association was governed by its own officers and had its own bank account. The funds of the association were invested in United States securities and the earnings and increment of these investments were used for the contemplated insurance benefits. The initial membership fee of one dollar and weekly dues of twenty-five cents were "automatically deducted" from the wages of each employee who had been employed for the required period. Before February 4, 1933, the bankrupt regularly paid to the association the accumulations of each payroll deduction, less such expenses of the association as were paid by the bankrupt. From the date above-mentioned, the bankrupt fell into arrears and until November 24, 1933, when receivers in equity were appointed, there was always an unpaid balance to the credit of the association. That balance at the time of the receivership amounted to $14,607.51. The deductions from wages were made by charging the employee's account on the payroll records of the bankrupt and crediting the aggregate of all such deductions to the account of the association on the books of the bankrupt. "No actual money was taken from the pay envelopes

of the employees and deposited in any account of the bankrupt, but to the contrary the matter was handled as a mere bookkeeping entry" and at no time did the bankrupt "segregate" any money due the association or "deposit any money in any separate trust account or bank account". The practice of the bankrupt was to deposit all its incoming revenue in its general bank account, from which it would from time to time withdraw moneys and establish various special accounts. The bankrupt was accustomed to withdraw from its general account or special accounts as the convenience of the situation required, and the payroll was drawn from the various accounts, both general and special, indiscriminately.

In August, 1933, the association was formally dissolved and, after setting up a fund to cover certain contingent obligations, all the other assets were conveyed to another unincorporated association, known as the Majestic Works Council, in which the bankrupt and its employees had equal representation. The Works Council appointed the respondent, Maurice Paradise, as trustee and authorized him to take proceedings to enforce its claim. It also appeared that subsequent to February 4, 1933, payment of the sums due the association had been demanded, and that payment had been requested from the equity receivers and refused.

The bankruptcy proceeding was begun in February, 1934, and respondent petitioned for the allowance of a preferential claim against the bankrupt's estate. The referee allowed the claim but his decision was reversed by the District Judge upon the ground that there was no trust and that, even if there was, the trust funds had not been traced into the hands of the trustee in bankruptcy. This ruling was reversed by the Circuit Court of Appeals which held that a trust had been created and that the preference should be allowed. 80 F. (2d) 478. In view of the contention of the petitioner that the decision was in conflict with applicable decisions of this Court, we granted certiorari. 298 U. S. 647.

We think that the facts afford no adequate basis for the conclusion that a trust existed. The underlying relation was that of employer and employee. With respect to wages that the employee earned, the relation was that of debtor and creditor. By agreement, a part of the amounts thus becoming due as wages was to be paid to the association. What would otherwise be a debt to the employee was to become a debt to the association. Whether the agreement be viewed as an assignment by the employee to the asso-

ciation of the claim to the part of the wages as the latter became due, or as a novation, the result was that the bankrupt owed the association the agreed sums. The book entries of debits on the payroll records and credits to the association evidenced that understanding.

It does not appear that it was contemplated that the bankrupt should accumulate or hold any fund. On the contrary, the practice prior to February, 1933, was that the bankrupt regularly paid to the association the agreed amounts. The later failure to pay did not alter the nature of the transaction. The bankrupt was a debtor which had failed to pay its debt. We know of no principle upon which that failure can be treated as a conversion of property held in trust. At no time throughout the whole period was there a trust fund or *res*. No fund was segregated or set up by special deposit or in any manner. When the wages became due, there was no such fund but only the general assets of the employer and its obligation to pay a debt. The agreement of the employer to pay the association instead of the employee did not give to the employee or the association equitable title to or lien upon any part of the employer's property. The assets of the employer remained, as they were before, general assets. It would be impossible to state all the circumstances in which equity will fasten a constructive trust upon property in order to frustrate a violation of fiduciary duty. See 3 Pomeroy, Equity Jurisprudence, secs. 1044, *et seq*. But the mere failure to pay a debt does not belong in that category. We do not find that the record shows anything more than that in this instance. Our observations in *Adams* v. *Champion*, 294 U. S. 231, 238, to which the Court of Appeals refers, have no relation to such a case. See *National City Bank* v. *Hotchkiss*, 231 U. S. 50; *Blakey* v. *Brinson*, 286 U. S. 254; *Jennings* v. *U. S. F. & G. Co.*, 294 U. S. 216; *Old Company's Lehigh* v. *Meeker*, 294 U. S. 227; *Edisto National Bank* v. *Bryant*, 72 F. (2d) 917, 920. The fact that the failure to pay the association was an acute disappointment and was especially regrettable as the claimant was an association of employees, cannot avail to change the debtor into a trustee or enable the creditor to obtain a preference over other claims against a bankrupt estate.

The decree of the Circuit Court of Appeals is reversed and that of the District Court is affirmed.

It is so ordered.